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MORTIMER ZUCKERMAN • PAUL KRUGMAN

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Russia's Phony Capitalism

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MAY/JUNE 1998
VOLUME 77, NUMBER 3

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America the Boastful *Paul Krugman* 32

Only a few years ago pundits were sure that the United States was losing to Asia and Europe and had to emulate their more state-directed economies to remain competitive. Now the conventional wisdom is that America is number one and that the rest of the world should adopt its more laissez-faire approach. In fact, neither caricature is right. Asia was booming and now it is slumping, but it will be back. Europe's underlying ossification will persist. But most important, while the U.S. economy is in a period of robust growth, nothing fundamental has changed. Its long-run growth rate has not accelerated, productivity has not risen, and the structural unemployment rate has fallen by one percentage point at most. Come the next recession, all this triumphalism will seem silly.

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Many observers of the Asian financial crisis have been tempted to declare the victory of American-style capitalism. Just as the fall of the Berlin Wall in 1989 vindicated America's political model—liberal democracy—so the collapse of Asia's markets in 1997 proved the wisdom of America's economic model—free-market capitalism. But it is presumptuous to think that the crisis foretells Asian acceptance of American ways. The facts are far more complex. The Asian economies best able to withstand the present crisis may be those with more political freedom, but the real key may be competent government. East Asia is changing, but it is not Americanizing.

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The French always seem to be opposing the United States on some issue or other. They coddle Saddam Hussein and denounce American "cultural imperialism." Why is France so difficult to deal with? It is, quite simply, in a bad mood, unsure of its place and status in a new world. The French are jealous of America, which seems to run the world; afraid of globalization, which threatens to erode their culture; and ambivalent about European unification, which might drown out their voice. France must meet these challenges while struggling with a cumbersome statist economy and a rising extreme right. To do it all, France must transcend itself.

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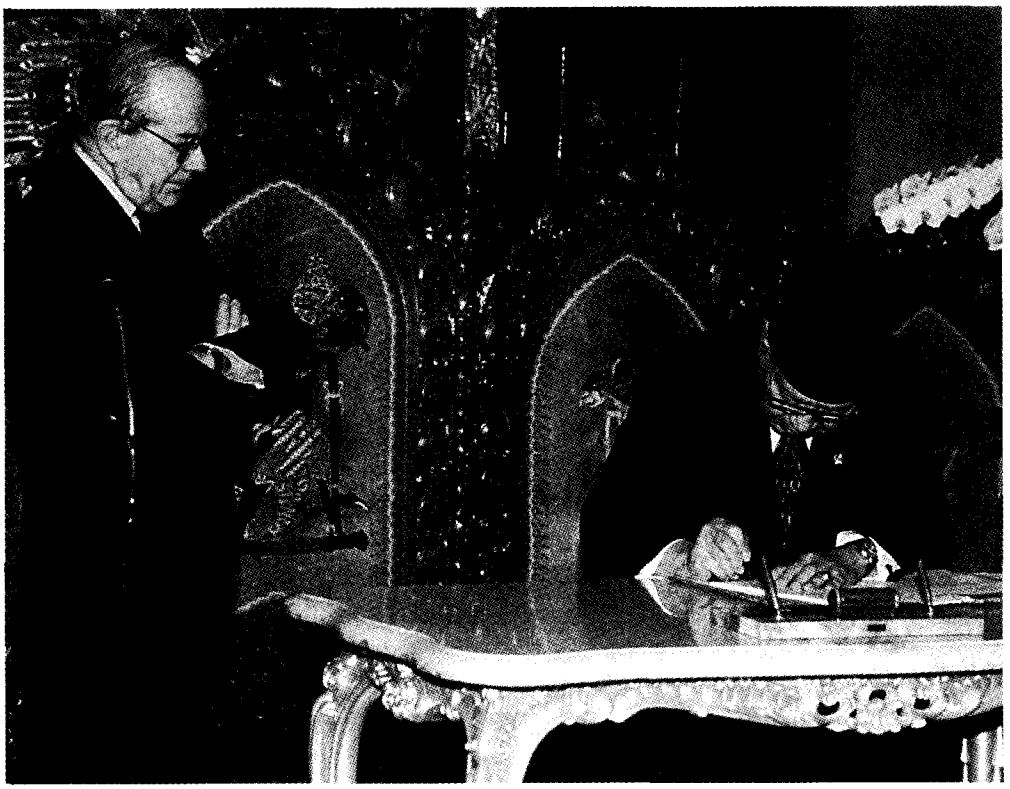

AP/WIDE WORLD PHOTOS

Michel Camdessus looks on as President Suharto signs a new IMF agreement, January 15, 1998

The IMF is increasingly inadequate to meet the political and economic demands of the modern world.

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Globalization and Its Discontents

Navigating the Dangers of a Tangled World

Richard N. Haass and Robert E. Litan

The period immediately following the Second World War, which produced the Marshall Plan, NATO, and the U.S.-Japan security treaty, is rightly regarded as foreign policy's golden era. But it also saw the birth of comparably successful economic institutions—such as the International Monetary Fund, the World Bank, the General Agreement on Tariffs and Trade—designed to promote long-term prosperity through stable exchange rates, worldwide development, and open trade. Today these institutions are increasingly subject to criticism. The IMF, for instance, has come under attack for imposing drastic conditions in its "rescues" of Mexico in 1995 and Asia today. The World Trade Organization, formed in 1995 as the result of American calls for a body to resolve market-access disputes, has been attacked in this country for usurping America's sovereignty. And doubts abound about the role of development banks in an era of massive direct foreign investment.

The gap between the legacy of Bretton Woods and the economic and political demands of the modern world is growing. Much of this change is driven by rapid advances in, and thus lower costs of, communications, information flows, and travel. Official policy, much of it American, has played its part by reducing barriers to the movement of goods and capital across national boundaries. The result has been more intrusive and intense economic interaction—including the explosive growth of world capital markets, which led to the demise of fixed exchange rates—between a large and growing number of entities outside government control, a phenomenon that has come to be called "globalization."

But globalization has its problems. In some quarters it is seen as having caused the rapid flows of investment that moved in and out of countries as investor sentiment changed and were behind the Mexican and Asian financial crises. In the United

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States it is blamed for job losses, increasing income inequality, and stagnant or deteriorating real wages. Domestic discontent with globalization thwarted the passage last year of legislation that would have granted the president "fast track" authority to negotiate trade arrangements that Congress could not modify.

Globalization has become a target. Its dangers must be navigated successfully or the United States and others may be compelled to backtrack, diminishing the free movement of goods, services, and capital, which would result in slower growth, less technological innovation, and lower living standards.

FREE-MARKET FOREIGN POLICY?

In this new world, poor economic policymaking, corrupt banking practices, dishonest accounting, and unrealistic currency alignments can have an impact on societies far removed. Although the United States, with its vast internal market, is considerably less "globalized" than other industrialized countries, millions of American jobs and billions of dollars are tied to economic developments elsewhere.

If there is consensus on the diagnosis, there is none on the prescription. There are at least three fundamentally different approaches to addressing the problems of the global economy.

The first embraces the free market and would abandon IMF-like rescue packages. It is motivated by the belief that the IMF lulls governments, investors, and lenders into recklessness. Emboldened by the prospect that the IMF will come to their rescue, they are free to act irresponsibly. In the words of George Shultz, William Simon, and Walter Wriston, IMF "interference will only encourage more crises." Mexico, in this view, led to Asia.

The laissez-faire, free-market approach looks good in the abstract because markets reward sound investments and regulatory practices and punish poor ones. In principle, it can provide incentives for investors to avoid overly risky investments and for governments to adopt prudent policies. To international free marketeers, safety nets destroy this incentive.

But this critique goes too far. Governments submitting to IMF rescue plans must often agree to wrenching reforms—not the kind of experience that invites other governments to be reckless. Similarly, investors in equity markets in Mexico and Asia were hit by depressed local stock prices and heavily devalued local currencies. The only parties that emerged relatively unscathed, and thus for whom the free market critique has some relevance, were certain creditors: holders of Mexican government debt during the Mexican crisis and banks in the recent Asian crisis.

The solution to this problem is not to remove the IMF—the international lender of last resort—but to develop ways to warn banks and other creditors that they will suffer in the event of a future crisis. During the Depression, Americans learned the cost of not having a functioning lender of last resort: a wave of bank and corporate failures, aggravated by a shortage of liquidity that the Federal Reserve failed to provide. The international equivalent of having no Fed is standing idly by while currencies plummet, countries run out of foreign exchange, trade and investment come to a halt, and crises in one region spread to others.

A hands-off approach would risk transforming limited crises into something

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much more costly. More than economics is at stake. Years of punishment by the marketplace are simply not acceptable when immediate strategic interests are involved, as they are, for example, in Mexico or South Korea. For better or worse, the United States cannot afford the collapse of countries vital to its national interest.

GOVERNING GLOBALIZATION

The second approach to taming the dangers of globalization could hardly be more different. It suggests the creation of new institutions to lend structure and direction to the global marketplace, complementing what is seen as the constructive but inadequate roles of the IMF and other bodies. For example, George Soros, arguing that "international capital movements need to be supervised and the allocation of credit regulated," has recommended creating the international equivalent of the United States' Fannie Mae, which guarantees residential mortgages for a fee. He calls for the establishment of an "International Credit Insurance Corporation" that would guarantee private sector loans up to a specified amount for a modest charge, while requiring that the borrowers' home countries provide a complete financial picture in order for them to qualify.

Henry Kaufman, a Wall Street economist, would go even further, creating a "Board of Overseers of Major International Institutions and Markets" that would set minimum capital requirements for all institutions, establish uniform accounting and lending standards, and monitor performance. It would even discipline those who did not meet these criteria by limiting the ability of those who remained outside the system to lend, borrow, and sell.

Governments are sure to resist supranational bodies that so fundamentally challenge their sovereignty. Moreover, except for extreme crises when an IMF-like rescue is warranted, it is difficult to understand why international officials could determine how much credit to allocate better than the market. There is more than a little irony in applying the "Asian model" of centralization to the international economy just when the model has been so thoroughly discredited.

A third approach, which would leave the basic architecture of the international economy alone but still do some "remodeling," would involve a number of reforms designed to structure and discipline financial operations and transactions. This managed approach would eschew the heavy hand of international regulation but aim to maintain the element of risk essential to capitalism without removing the safety net provided by the IMF. This approach is closest to the manner in which the United States dealt with the savings and loan and banking crises of the 1980s: enacting legislation requiring shareholders to maintain a larger financial commitment to their banks while making it more difficult for regulators and policymakers to bail out large, uninsured depositors who could previously count on being protected. The challenge for the international community is to introduce the equivalent of the U.S. reforms at both the national and international levels.

Such reforms are already being worked on at the behest of the IMF. They include improving the supervision of financial institutions, instituting Western-style accounting practices in banks and corporations, and opening up markets to foreign investment. To ensure that these reforms

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are carried out, some other international body, such as the Bank for International Settlements or perhaps a nongovernmental organization, should issue regular "report cards" on individual countries' progress. In addition, the IMF must press countries to be forthcoming with accurate information about key financial data, including their current account positions, foreign exchange reserves, and short-term indebtedness to foreign creditors. Banks and investors will favor countries that are positively rated, and penalize or avoid those that are not. Governments and institutions will introduce desirable reforms lest they lose out.

More transparency and information is necessary but not sufficient for markets to avoid excesses. The challenge is to find effective ways of addressing the free market critique. A possible solution is for the IMF to condition its assistance on countries' penalizing all lenders of foreign currency in the event IMF intervention is required. In particular, the model legislation that each country could adopt would require (as long as an IMF rescue is in effect) that creditors automatically suffer some loss of their principal when their debt matures and is not rolled over or extended. This approach would discourage the sudden outflow of maturing debt when countries can least afford it. The threat of automatic loss in the event a country experiences economic crisis could underscore to banks and other creditors that their money is at risk and that they can no longer count on the IMF to bail them out. Creditors would respond, of course, by insisting on higher interest rates for borrowers with opaque or poorly capitalized balance sheets. But that is precisely the point: the price of loans should better reflect the risk of not getting repaid.

The Asian crisis demonstrates the need for more formal bankruptcy codes and mechanisms for restructuring the balance sheets of heavily indebted firms without necessarily shutting them down. Existing international institutions can assist countries in this area, as well as in strengthening bank supervision and accounting standards, but there is no need to establish a new international bankruptcy court or to vest existing international institutions with such powers. The United States has a bankruptcy code and process that handles insolvency of firms located here, even when they have foreign creditors. There is no reason why other countries cannot do the same thing.

THE HOME FRONT

To paraphrase former House Speaker Tip O'Neill, all economics is local. Policies promoting unfettered trade and investment will be rejected by Congress unless steps are taken to build a firm domestic political base. Once again, there are three approaches to choose from, running the gamut from laissez faire to heavy regulation. A pure market approach—one that would let the chips (and the workers) fall where they may—would be neither fair nor politically sustainable. Some sort of safety net is both desirable and necessary. At the same time, it would be foolish to try to insulate Americans from all of globalization's effects. It is impossible to protect jobs rendered obsolete by technological change and foreign competition. What lies between is a managed approach that helps workers cope with the consequences of globalization. It would both change and supplement existing programs and policies.

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Since 1962, American policymakers have provided extended unemployment insurance to workers who can prove they were displaced primarily because of international trade. But this discourages workers from looking for employment, channeling them toward government training programs with little proven success. Moreover, it does not compensate workers for the cuts in pay they take even after finding new jobs. A more effective program would pay workers a portion of the difference between their wages at their previous and new jobs. This kind of earnings insurance would encourage workers to take new jobs even if they paid less, and offer the only real training that works—on the job. Workers could also be provided with benefits—health insurance, pensions, training, and unemployment insurance—that they could take with them when moving to a new employer.

Some will argue that portable benefits and earnings insurance are not enough. But globalization is a reality, not a choice. "You can run but you can't hide" might serve as the mantra for the age.

Those who urge us to hide by resurrecting barriers to trade and investment, with the ostensible aim of insulating Americans from the forces of globalization, would abandon America's commitment to the spread of markets and democracy around the world at precisely the moment these ideas are ascendant. Moreover, the potential economic and political cost would be enormous, depriving Americans of cheaper and in some cases higher quality goods and services, as well as denying them the opportunity to work at better paying jobs that depend on exports.

The real choice for governments is not how best to fight globalization but how to manage it, which will require creative policies both at home and abroad. It is ironic: the age of globalization may well be defined in part by challenges to the nation-state, but it is still states and governments—by the practices they adopt, the arrangements they enter into, and the safety nets they provide—that will determine whether we exploit or squander the potential of this era.

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The Capital Myth

The Difference between Trade in Widgets and Dollars

Jagdish Bhagwati

In the aftermath of the Asian financial crisis, the mainstream view that dominates policy circles, indeed the prevalent myth, is that despite the striking evidence of the inherently crisis-prone nature of freer capital movements, a world of full capital mobility continues to be inevitable and immensely desirable. Instead of maintaining careful restrictions, we are told, the only sensible course is to continue working toward unfettered capital flows; the favored solution is to turn the IMF even more firmly into an international lender of last resort that dispenses bailout funds to crisis-afflicted countries. The IMF took an important step in this direction at its annual meeting in Hong Kong last September, when the Interim Committee issued a statement virtually endorsing an eventual move to capital account convertibility—which means that you and I, nationals or foreigners, could take capital in and out freely, in any volume and at any time—for IMF members. The obligations originally listed in 1944 in the Articles of Agreement, on the other hand, included only "avoidance of restrictions on payments for current transactions" and did not embrace capital account convertibility as an obligation or even a goal.

This is a seductive idea: freeing up trade is good, why not also let capital move freely across borders? But the claims of enormous benefits from free capital mobility are not persuasive. Substantial gains have been asserted, not demonstrated, and most of the payoff can be obtained by direct equity investment. And even a richer IMF with attendant changes in its methods of operation will probably not rule out crises or reduce their costs significantly. The myth to the contrary has been created by what one might christen the Wall Street–Treasury complex, following in the footsteps of President Eisenhower, who had warned of the military-industrial complex.

CAPITAL MOBILITY IDEOLOGY

Until the Asian crisis sensitized the public to the reality that capital movements could repeatedly generate crises, many assumed that free capital mobility among

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all nations was exactly like free trade in their goods and services, a mutual-gain phenomenon. Hence restricted capital mobility, just like protectionism, was seen to be harmful to economic performance in each country, whether rich or poor. That the gains might be problematic because of the cost of crises was not considered.

However, the Asian crisis cannot be separated from the excessive borrowings of foreign short-term capital as Asian economies loosened up their capital account controls and enabled their banks and firms to borrow abroad. In 1996, total private capital inflows to Indonesia, Malaysia, South Korea, Thailand, and the Philippines were $93 billion, up from $41 billion in 1994. In 1997, that suddenly changed to an outflow of $12 billion. Hence it has become apparent that crises attendant on capital mobility cannot be ignored.

Although it is conceded that this downside exists, many claim that it can be ameliorated, if not eliminated, and that free capital mobility's immense advantages can be enjoyed by all. Conservatives would do this by letting the markets rip, untended by the IMF, which could then be sidelined or even disbanded. Liberals would do it instead by turning the IMF into the world's lender of last resort, dispensing funds during crises with several sorts of conditions, and overseeing, buttressing, and managing the world of free capital mobility.

To understand why neither of these modifications is enough, it is necessary to understand why the original version of the myth, which has steadily propelled the IMF into its complacent and dangerous moves toward the goal of capital account convertibility, was just that. True, economists properly say that there is a correspondence between free trade in goods and services and free capital mobility: interfering with either will produce efficiency losses. But only an untutored economist will argue that, therefore, free trade in widgets and life insurance policies is the same as free capital mobility. Capital flows are characterized, as the economic historian Charles Kindleberger of the Massachusetts Institute of Technology has famously noted, by panics and manias.

Each time a crisis related to capital inflows hits a country, it typically goes through the wringer. The debt crisis of the 1980s cost South America a decade of growth. The Mexicans, who were vastly overexposed through short-term inflows, were devastated in 1994. The Asian economies of Thailand, Indonesia, and South Korea, all heavily burdened with short-term debt, went into a tailspin nearly a year ago, drastically lowering their growth rates. Sure enough, serious economic downturns and crises can arise even when governments are not particularly vulnerable due to short-term borrowing: macroeconomic mismanagement in Japan has restrained its growth rate for nearly seven years now, and Japan is still a net lender of capital. But it is a non sequitur to suggest, as the defenders of free capital mobility do, that this possibility somehow negates the fact that short-term borrowings under free capital mobility will be, and have been, a source of considerable economic difficulty.

DOWNSIZING GAINS

When a crisis hits, the downside of free capital mobility arises. To ensure that capital returns, the country must do everything it can to restore the confidence of those who have taken their money out. This typically means raising interest rates, as the IMF has required of Indonesia. Across Asia this

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ARCHIVE PHOTOS

Crisis on line one: Filipino traders react as Manila's stock market tumbles, October 28, 1997

has decimated firms with large amounts of debt. It also means having to sell domestic assets, which are greatly undervalued because of the credit crunch, in a fire sale to foreign buyers with better access to funds. (Economists have usually advised the exact opposite in such depressed circumstances: restricting foreign access to a country's assets when its credit, but not that of others, has dried up.) Thus, Thailand and South Korea have been forced to further open their capital markets, even though the short-term capital inflow played a principal role in their troubles in the first place.

Besides suffering these economic setbacks, these countries have lost the political independence to run their economic policies as they deem fit. That their independence is lost not directly to foreign nations but to an IMF increasingly extending its agenda, at the behest of the U.S. Congress, to invade domestic policies on matters of social policy—as with the 1994 Sanders-Frank Amendment, which seeks to attach labor standards conditions to any increase in bailout funds—is small consolation indeed.

Thus, any nation contemplating the embrace of free capital mobility must reckon with these costs and also consider the probability of running into a crisis. The gains from economic efficiency that would flow from free capital mobility, in a hypothetical crisis-free world, must be set against this loss if a wise decision is to be made.

None of the proponents of free capital mobility have estimated the size of the gains they expect to materialize, even leaving out the losses from crises that can ensue. For free trade, numerous studies have measured the costs of protection. The overwhelming majority of trade economists judge the gains from free

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trade to be significant, coming down somewhere between Paul Krugman's view that they are too small to be taken seriously and Jeffrey Sachs' view that they are huge and cannot be ignored. But all we have from the proponents of capital mobility is banner-waving, such as that of Bradford De Long, the Berkeley economist and former deputy assistant secretary for economic policy in the Clinton administration:

> So now we have all the benefits of free flows of international capital. These benefits are mammoth: the ability to borrow abroad kept the Reagan deficits from crushing U.S. growth like an egg, and the ability to borrow from abroad has enabled successful emerging market economies to double or triple the speed at which their productivity levels and living standards converge to the industrial core.

And of Roger C. Altman, the investment banker, who served in the Treasury Department under Presidents Clinton and Carter:

> The worldwide elimination of barriers to trade and capital . . . have created the global financial marketplace, which informed observers hailed for bringing private capital to the developing world, encouraging economic growth and democracy.[1]

These assertions assume that free capital mobility is enormously beneficial while simultaneously failing to evaluate its crisis-prone downside. But even a cursory glance at history suggests that these gains may be negligible. After all, China and Japan, different in politics and sociology as well as historical experience, have registered remarkable growth rates without capital account convertibility. Western Europe's return to prosperity was also achieved without capital account convertibility. Except for Switzerland, capital account liberalization was pretty slow at the outset and did not gain strength until the late 1980s, and some European countries, among them Portugal and Ireland, did not implement it until the early 1990s.

Besides, even if one believes that capital flows are greatly productive, there is still an important difference between embracing free portfolio capital mobility and having a policy of attracting direct equity investment. Maybe the amount of direct foreign investment that a country attracts will be reduced somewhat by not having freedom of portfolio capital flows, but there is little evidence for this assertion. Even then such a loss would be a small fraction of the gains from having a pro–foreign investment strategy.

A WALL STREET–TREASURY COMPLEX

That brings us to the myth that crises under capital account convertibility can be eliminated. We have, of course, heard this assertion before as each crisis has been confronted, and then we have been hit by yet another one. Like cats, crises have many lives, and macroeconomists, never a tribe that enjoyed a great reputation for getting things right or for agreeing among themselves, have been kept busy adding to the taxonomy of crises and their explanations. None of the solutions currently propounded can

[1]Bradford De Long, "What's Wrong with Our Bloody Economies?" January 11, 1998, from his World Wide Web page, http://econ161.berkeley.edu/; Roger C. Altman, "The Nuke of the 90's," *The New York Times Magazine*, March 1, 1998, p. 34.

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really rid the system of free capital mobility of instability.

Thus, while no one can disagree with Secretary of the Treasury Robert Rubin's contention that reform of banking systems around the world will help, few should agree with him that it will eliminate the crises that unregulated capital flows inherently generate. Nor can the abolition of the IMF and its lender of last resort bailouts be the magic bullet: there were crises before the writer Walter Bagehot invented this function for domestic central banks in the nineteenth century. Nor can making the IMF more powerful kill the crises or give it the nonexistent macroeconomic wisdom to manage them at least cost when they arise.

In short, when we penetrate the fog of implausible assertions that surrounds the case for free capital mobility, we realize that the idea and the ideology of free trade and its benefits—and this extends to the continuing liberalization of trade in goods and financial and other services at the World Trade Organization—have, in effect, been hijacked by the proponents of capital mobility. They have been used to bamboozle us into celebrating the new world of trillions of dollars moving about daily in a borderless world, creating gigantic economic gains, rewarding virtue and punishing profligacy. The pretty face presented to us is, in fact, a mask that hides the warts and wrinkles underneath.

The question, then, is why the world has nonetheless been moving in this direction. The answer, as always, reflects ideology and interests—that is, lobbies. The ideology is clearly that of markets. The steady move away from central planning, overregulation, and general overreach in state intervention toward letting markets function has now reached across many sectors and countries. This is indeed all to the good and promises worldwide prosperity. But this wave has also lulled many economists and policymakers into complacency about the pitfalls that certain markets inherently pose even when they were understood in the classroom. Free capital mobility is just one example of this unwarranted attitude. Indeed, Stanley Fischer, the deputy managing director of the IMF, admitted in a February appearance on the *Charlie Rose* show on PBS that he had underestimated the probability of such crises arising in a world of capital mobility.

But interests have also played a central role. Wall Street's financial firms have obvious self-interest in a world of free capital mobility since it only enlarges the arena in which to make money. It is not surprising, therefore, that Wall Street has put its powerful oar into the turbulent waters of Washington political lobbying to steer in this direction. Thus, when testifying before the Senate Foreign Relations Committee on South Asia in March 1995, right after the Mexican peso crisis, I was witness to the grilling of Undersecretary of Commerce Jeffrey E. Garten on why India's financial system was not fully open to U.S. firms. To his credit, Garten said that this was not exactly a propitious time for the United States to pressure India in this direction.

Then again, Wall Street has exceptional clout with Washington for the simple reason that there is, in the sense of a power elite à la C. Wright Mills, a definite networking of like-minded luminaries among the powerful institutions—Wall Street, the Treasury Department, the State Department, the IMF, and the World Bank most prominent among them. Secretary Rubin comes from Wall Street; Altman went from Wall Street to

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the Treasury and back; Nicholas Brady, President Bush's Secretary of the Treasury, is back in finance as well; Ernest Stern, who has served as acting president of the World Bank, is now managing director of J.P. Morgan; James Wolfensohn, an investment banker, is now president of the World Bank. One could go on.

This powerful network, which may aptly, if loosely, be called the Wall Street–Treasury complex, is unable to look much beyond the interest of Wall Street, which it equates with the good of the world. Thus the IMF has been relentlessly propelled toward embracing the goal of capital account convertibility. The Mexican bailout of 1994 was presented as necessary, which was true. But so too was the flip side, that the Wall Street investors had to be bailed out as well, which was not. Surely other policy instruments, such as a surcharge, could have been deployed simultaneously to punish Wall Street for its mistakes. Even in the current Asian crisis, particularly in South Korea, U.S. banks could all have been forced to the bargaining table, absorbing far larger losses than they did, but they were cushioned by the IMF acting virtually as a lender of first, rather than last, resort.

And despite the evidence of the inherent risks of free capital flows, the Wall Street-Treasury complex is currently proceeding on the self-serving assumption that the ideal world is indeed one of free capital flows, with the IMF and its bailouts at the apex in a role that guarantees its survival and enhances its status. But the weight of evidence and the force of logic point in the opposite direction, toward restraints on capital flows. It is time to shift the burden of proof from those who oppose to those who favor liberated capital.

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The Natural Market Fallacy

Slim Pickings in Latin America

Bernard K. Gordon

A central issue in this era of globalization is whether any regional trade grouping—in Asia, Europe, or the Americas—represents the best course for the world economy, and whether the United States in particular has any natural markets. President Clinton's proposal for a Western Hemisphere free trade area, announced at the Miami summit in December 1994, is grounded in the conviction that the United States has such a market in Latin America. His vision, in essence the creation of a much-expanded North American Free Trade Agreement (NAFTA) by the year 2005, sounds grand. But even if Latin American states were to accept the labor and environmental controls Congress wants to include in new trade agreements, they are far less attractive trading partners for the United States than Mexico and Canada. Moreover, the drive toward economic regionalism would move the global economy in the wrong direction.

U.S. exports to Latin America, particularly to the economies of South America, are limited. The Commerce Department is fond of including the region's largest economy, Brazil, among the world's big emerging markets. However, what Brazil and other emerging markets truly have in common is that they have all been slow-growing as customers for U.S. exports. These limitations stem from a continuing history of aggressive protectionism and an insistence that foreign firms produce their goods in-country. The automobile industry provides a good illustration. In Brazil, the tariff on imported cars of 63 percent is cut in half for locally made cars that have significant local content.

The overall result of such policies is that U.S. merchandise exports to Brazil were $12.7 billion in 1996—sizable, but little more than the $12 billion the United States exported to thinly populated Australia. For additional perspective, consider that in 1996 the United States exported $26 billion to Korea, $18 billion to Taiwan, and $16 billion to Singapore, three Asian tigers with far smaller populations than Brazil. America's exports per capita to comparable markets are similarly revealing. In 1996 America's per capita exports were $604 to Mexico, $430 to Malaysia, $291 to Chile, $132 to Argentina, $120 to Thailand—and just $80 to Brazil's vaunted big emerging market.

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These statistics illustrate an often forgotten fact about U.S. exports to South America: aside from the 14.5 million Chileans, most people in South America have not been particularly good customers for U.S. products. Americans tend to think otherwise because of the way U.S. exports are reported: South America is commonly combined with Central America and Mexico to form the single category of Latin America. But lumping Mexico together with Central and South America conceals more than it reveals, and in particular hides two basic facts about Mexico. The first is the large size of the Mexican market for U.S. products. The second is that as a result of history and geography, America's products and investment have dominated Mexico's economy since Grover Cleveland was president.

EUROPE'S BAILIWICK

America's century-long dominance in Mexico was obviously not the result of NAFTA. After all, it was in 1985, a decade before NAFTA was negotiated, that Mexico became America's third-largest market, and it was in 1990 that Mexico first bought more from the United States than did all the rest of South and Central America combined. That gap now exceeds $15 billion and continues to widen. Mexico's imports of $56 billion from the United States in 1996 maintained its position as America's third-largest market, after Canada and Japan. Mexico's per capita imports from the United States are also large. Little or none of that commerce is NAFTA's creation, although the treaty is expanding both nations' exports.

America's economic relationship with South America is fundamentally different. In the South American economies, unlike Mexico's, the nations of Western Europe have long had a major role. In Brazil and Argentina, the region's major players, Europe has been dominant. In Brazil's market, close competition between the United States and Western Europe gave way to clear dominance by European suppliers by 1993 and a lead of $2.5 billion in imports by 1996 ($15.5 billion versus $13 billion). In Argentina, Western Europe has consistently led the United States, and the gap ($7 billion versus $5 billion) has become pronounced in recent years. Because the Argentine market is so much smaller than Brazil's, the $2 billion lead is even more significant.

The pattern in exports is also clear. Brazil's exports to the countries of the European Union have been well above those to the United States since at least 1988. The difference was almost $5 billion in 1996. Argentina's exports to the EU have consistently been twice the level of those to the United States for more than 20 years. In 1996 Argentina's exports to the Netherlands and Germany alone equaled those to the United States.

Investment patterns tell the same story. While many believe U.S. investment dominates South America, the reality is different. According to studies by the United Nations and the Organization for Economic Cooperation and Development, Western Europe has been South America's heaviest investor, especially in its larger economies. In Argentina, for example, where total foreign investment through 1989 was $6.5 billion, more than half was from Western Europe. In Brazil, America's secondary role is even more stark: of a total of $35 billion invested through 1990, the U.S. share was $10.5 billion—less than the total investment stock of just Germany, Great Britain, and Switzerland. In total,

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Western Europe accounted for nearly twice the U.S. share. The same pattern applies to South America as a whole.

UNNATURAL MARKETS

These trade and investment figures show that aside from Mexico, Latin America is not a natural market for the United States. President Clinton, like President Bush before him, sees an enlarged NAFTA as the model for a Free Trade Area of the Americas (FTAA), but it is a model that does not fit. NAFTA grew from America's long-standing dominance of both Canadian and Mexican trade and investment, and the benefits of trade with Mexico and Canada are the result of America's historical relationship with those two countries, not NAFTA. That bond has been absent in South America, and an FTAA will not create it.

In 1980, more than 60 percent of Canada's exports were already directed to the United States; by 1995, that had risen to 80 percent. Likewise, two-thirds of Mexico's exports went to the United States in 1980, and by 1995, that share had risen to 83 percent. More than two-thirds of Canada's imports consistently have come from the United States, and the U.S. share of Mexico's imports rose from 61 percent in 1980 to 75 percent in 1995.

There is no parallel U.S. role in South America. For the past quarter-century South American imports from the United States have not reached even 30 percent of total imports, and since the early 1980s they have averaged just 26 percent. Even in Chile, where both exports and imports have become quite geographically diversified, imports from the United States have averaged just 21 percent.

RISKS OF RIVALRY

Any advantages from extending NAFTA to the rest of the hemisphere will be outweighed by several disadvantages. First, by pressing for an FTAA, President Clinton will be promoting the spread of regionalism, which, under the conditions that have shaped international trade through most of the postwar era, is a misfit from an earlier age. Especially in the form best known as regional free trade areas—but which Jagdish Bhagwati and other economists have rightly called preferential trade areas—economic regionalism's main flaw is its central nature: it is based on geographic proximity.

Proximity was a key factor in foreign trade before World War II, when knowledge of foreign markets for one's products and the cost of transporting them made neighbors and near-neighbors each other's most likely best customers. But today distance has become essentially irrelevant. In an era when containerized shipping has drastically lowered the costs associated with bulk freight, the most distant markets for moving great quantities of high-value products have been opened up by express air freight, and electronic communication has made price and product data instantly available, the difference between Kuala Lumpur and Rio de Janeiro has become not a question of distance but of which market has the customers with the most money.

Moreover, regional trading blocs will undermine America's leading role in world trade, which developed from the current global trading regime. Even now, leaders in Brazil, who have long regarded the United States as their rival for hemispheric leadership, have seized on the difference between Clinton's FTAA and their own southern Latin American trade grouping, MERCOSUR, as a reason for an imagined contest. MERCO-

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SUR is an old-fashioned customs union, with a single tariff against all outsiders. Brazil's commitment to rivalry with the United States was underscored in late 1996 when it quashed a study by the World Bank's chief trade economist, Alexander Yeats, that criticized MERCOSUR. He showed that MERCOSUR's promotion of Brazilian-Argentine trade came at the expense of both countries' economic efficiency and welfare because MERCOSUR had diverted trade from lower-cost producers. At Brazil's insistence, the study's publication was delayed and stripped of most criticisms of MERCOSUR.

The purported contest with Brazil is one the United States should not enter. An FTAA has no political urgency for the United States and, just as important, no economic merit for either America or the world economy. Clinton's vision is a retrograde threat to both: it would undermine America's unrivaled stake in the multilateral global economy, which it has built almost single-handedly since World War II, symbolized by the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO). It is the multilateral and global trading systems from which the United States has most benefited, and to which it should remain strongly committed.

One measure of how well the American economy has performed since World War II is that the United States is once again the world's leading exporter, with a historically unprecedented portion of its economy now connected to markets everywhere in the world. To risk undermining the global trade regime because of an imagined natural market in South and Central America, and to risk making Japan and others in Asia look defensively to their own region, is not in the U.S. national interest.

AMERICASCLEROSIS?

Despite the success of the GATT-WTO format, the growth of regional sentiment, stemming from the undoubted success of Europe's trade model in the 1960s and 1970s, has accelerated. Americans need to recognize that Europe's initially successful efforts at regional economic integration have begun to reach their limits. In Germany in particular there is heightened awareness that while the level of intra-European trade—often exceeding two-thirds of the countries' total international commerce—has brought many benefits, it has more recently been accompanied by industrial stagnation and a growing inability to compete in world markets.

One indication of that awareness is that the Federation of German Industry, the country's largest industry association, has sponsored a study of a possible new EU-U.S. trade relationship that would lead to a Transatlantic Free Trade Area. Its 1996 report argued that Europe's economic regionalism has reached its limits: "Recognizing the high costs which protection inflicts on the economy, German trade policy should strive to promote global free trade. If it is possible to apply [the] Transatlantic Free Trade Area (TAFTA) for this purpose, most German firms will win." These second thoughts about European economic regionalism, the prospect that an FTAA would undermine the global trading regime by promoting regionalism in Asia and elsewhere, and the evidence that there is no natural market for the United States in the Western Hemisphere should be a wake-up call for Americans when they are asked again to support President Clinton's call for a Free Trade Area of the Americas.

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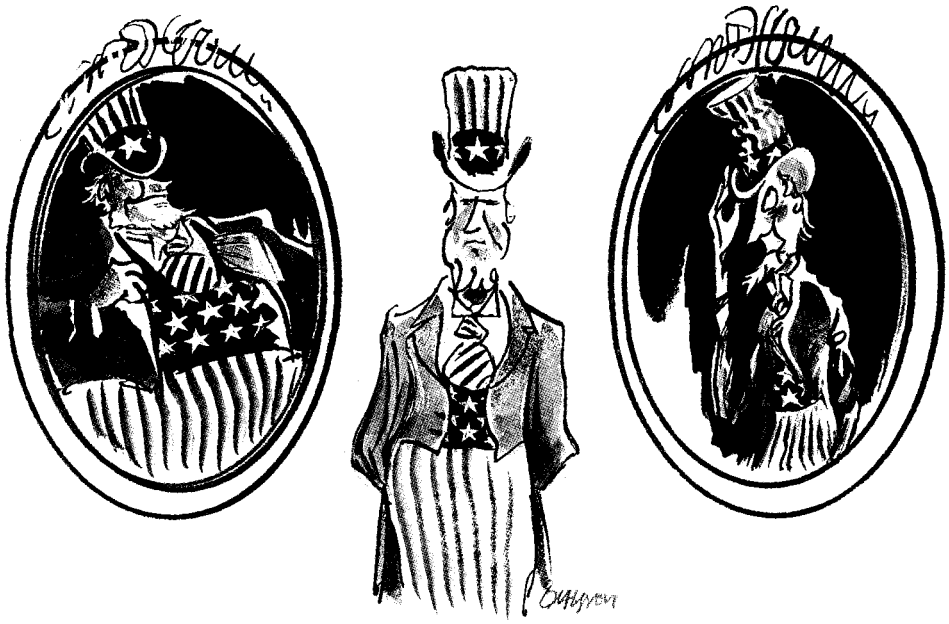
Essays



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Debate

A Second American Century

Mortimer B. Zuckerman

WHY WE WILL REMAIN NUMBER ONE

THE AMERICAN economy is in the eighth year of sustained growth that transcends the "German miracle" and the "Japanese miracle" of earlier decades. Everything that should be up is up—GDP, capital spending, incomes, the stock market, employment, exports, consumer and business confidence. Everything that should be down is down—unemployment, inflation, interest rates. The United States has been ranked number one among major industrial economies for three years in a row. America is riding a capital spending boom that is modernizing its existing industrial base and expanding its industrial capacity. The Dow Jones Industrial average is more than four times as high as it was six years ago. The New York and NASDAQ stock exchanges have added over $4 trillion in value in the last four years alone—the largest single accumulation of wealth in the history of the United States. By contrast, Europe is stagnating and burdened with double-digit unemployment, and Asia is floundering in the wake of financial collapse.

This is no fluke. The unique American brand of entrepreneurial bottom-up capitalism is made up of structural elements that have wrought

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the stunning economic success of the 1990s and are likely to provide the basis for extending America's comparative advantage over time.

Consider where the country has come from and where it is undoubtedly going. America was all but written off in the 1980s because of its apparently uncontrollable fiscal deficit and its products' steady loss of competitiveness in the global economy. Downsizing and restructuring depressed everyone, but that valley is now largely traversed. In a literal application of Schumpeter's notion of creative destruction, the United States lost some 44 million jobs in the process of adjusting its economy but simultaneously created 73 million private-sector jobs—a net gain of over 29 million jobs since 1980. A stunning 55 percent of the total work force today is in a new job, some two-thirds of them in industries that pay more than the average wage. Contrast all of continental Europe, with its larger economy and work force. It has created an estimated 4 million jobs in the same time period, virtually all of which are in the public sector. Since 1991, the European Union has lost about 5 million jobs while the U.S. economy has created more than 14 million new ones. Today a record 64 percent of American adults are working, the unemployment rate has fallen to 4.6 percent, and GDP growth has accelerated at the rate of close to 4 percent over the last two years.

In the past, such figures have raised the red flag of inflation. But inflation is at a 30-year low and, like unemployment, is still falling. This contradicts the historical experience of the late phase of a traditional business cycle, where accelerated growth usually correlates with higher inflation. Disinflation is emerging in commodities, which are hitting record lows, and was present in manufactured goods even before the impact of cheaper Asian exports. All this is happening despite an economy that seems close to the maximum sustainable level of growth. Nowhere does there seem to be an imminent inflationary threat. The markets do not anticipate it, and many in the private sector accept what many economists, including Chairman Alan Greenspan of the Federal Reserve, believe—that the official consumer price index overstates inflation by at least a percentage point. If that is correct, it means the United States is closing in on a zero-inflation economy.

Low inflation means lower interest rates, more capital investment, rising productivity, and higher growth—a virtuous cycle not likely to be broken by external forces. Despite a slowing and riskier global

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economy, the United States remains a balanced economy with the world's most buoyant domestic demand and a more limited exposure than other major industrial nations to exports, which account for only 13 percent of U.S. GDP. Moreover, U.S. exports are less vulnerable because they are diversified around the world and consist primarily of value-added goods, worldwide branded products that incorporate sophisticated technology and intellectual capital and do not have to compete on price alone. Exports are rising three times as fast as the overall economy, which is especially notable because it takes place not as a result of dollar devaluation but in the face of dollar appreciation. Exports are growing even more rapidly in the sectors where America dominates, such as advanced semiconductors, computer network servers, personal computers, software and services, entertainment, finance, and telecommunications. The United States dominates the knowledge industries of the future. Americans spend vastly more on research and development in these areas than their competitors, and the gap between the United States and the rest of the world will grow, not contract. America dominates the world of the Internet. Some 90 percent of web sites are American. U.S. companies are the major suppliers of the information age's silicon brains and sinews.

On the brink of the 21st century, the United States is at a point reminiscent of its entry into the twentieth. Frederick Jackson Turner pronounced the end of the American frontier in 1893. The newly settled continent, linked by rail, lay open as a vast, tariff-free marketplace, conducive to mass-produced products at prices the masses could increasingly afford—Edison's electric lights, Singer's sewing machines, Bell's speaking tubes, Ford's automobiles. Unimpeded access to that burgeoning marketplace was the one indispensable condition for the flowering of American enterprise.

EXPLAINING SUCCESS

TODAY, OF COURSE, the new frontier is the global economy. Evidence is growing that the United States is as well placed to exploit that as it was the new continental marketplace of a century ago. There are structural strengths that explain U.S. economic success and why it can be sustained.

An examination of these structures of advantage can begin with the improvement of American management skills. American managers

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were unprepared when global competition began to emerge in the 1970s and 1980s. Long sheltered by domestic regulation, lucrative contracts with the Defense Department, and earnings and growth boosted by inflation, they had a nasty awakening. Foreign competition took market share at both the high end and the low. Profits plummeted, thousands of companies failed or fell to takeovers, and famous brand names were humbled. Business managers, shocked out of their smug parochialism, began years of restructuring, reengineering, and cost-cutting that saw their companies become vastly more efficient. America is now the lowest-cost, most flexible producer among the industrial nations, with something like a $10-an-hour cost per worker advantage, fully loaded, over Japan and a $20-an-hour cost advantage over Germany.

America supplies the information age's silicon sinews.

To bring this about, American managers invested in new technologies, high-tech training to exploit these new advances, increased quality control, and improved information systems to adjust supply, prices, and output more quickly to market conditions. U.S. companies were the first to realize the importance of computers and information technologies and have invested massively in them, accounting for over 40 percent of the world's investment in computing. They spend more than twice as much per capita on "infotech" as Western European firms and eight times the global average; there are more than five times as many computers per worker in the United States as in Europe and Japan. U.S. manufacturing has replaced large mass-produced consumer products with sophisticated goods derived from intellectual output in knowledge-based industries, the fastest–growing segment of the world's economy. Management has been assisted by labor flexibility that is the envy of both Europe, where the legacy of the steam age is craft, union, and management demarcations that limit management's role, and Asia, where management is stifled by large oligopolistic networks and government mandates. Management incentives were increased by linking compensation to shareholder returns through stock options.

These are some of the reasons why profit margins in American corporations, once among the world's worst, are now among its best.

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Return on equity has more than doubled, to over 20 percent, and retained earnings have become the principal source of America's capital regeneration. This microeconomic vitality has translated into the macroeconomic success of the American economy.

RUGGED INDIVIDUALISM

THE ACHIEVEMENTS of business in America grew out of a culture that has long valued individualism, entrepreneurialism, pragmatism, and novelty. This legacy has outlived the passing of the frontier and still inspires millions. American culture nourishes its mavericks, cherishes its young, welcomes newcomers, and dramatically opens to energy and talent rising from the bottom up. In the nineteenth century, men like Carnegie, Frick, Rockefeller, and Morgan seized their chances. Today, their heirs are Bill Gates, Ted Turner, Larry Ellison, Craig McCaw, and the many others who vie for the top of *Forbes'* list of the 400 richest people in America.

American history uniquely encouraged the development of a management culture. The anthropologist Lionel Tiger showed that the development of American corporate management was America's response to a huge market, vast distances, and diverse populations, and the administrative and economic challenges they presented. Furthermore, what has dominated our business world is contract and law rather than kinship and custom, not primogeniture but an impersonal, monetized market economy and a belief in technology and scientific management. Indeed, the science of management was invented by an American, Frederick Winslow Taylor, who pioneered the time-and-motion study and was the father of mass-production techniques. No other country met the requirements of an emerging industrial system that needed people to be mobile, both physically and psychologically. No other country, for example, shares the American belief in numbers and statistics as the basis for decision-making. No other country has a population so prone to self-help, self-improvement, and even self-renovation in a manner that carries over into business life. No other country invests so much in the business training and retraining of its people—some $100 billion a year—in addition to having the largest and best graduate and undergraduate business schools in the world. And no other country sees its most talented move so overwhelmingly

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into the private sector, where the most successful are celebrated and rewarded as symbols in a nation of doers.

Entrepreneurialism and individual initiative in this country are so widely accepted that in the 1990s approximately 1.8 million businesses will have been started, on top of 1.5 million in the 1980s. Smaller companies have demonstrated their capacity to compete in this swiftly changing environment with flexibility, rapid response, openness, innovation, and the ability to attract the best people. Blue chip, large-scale companies no longer have a lock on recruiting the best and brightest graduates of elite business schools. Thousands of these smaller companies have had the potential to blossom and grow, even as thousands have gone belly-up. And as soon as new products and services are developed, American business' unique marketing and advertising skills establish their success at home and abroad.

From among these business start-ups have emerged the smaller companies that have provided the energy in our economy and the sources of our job growth. In contrast, the sprawling *Fortune* 500 companies lost approximately 3 million jobs in the 1980s and are expected to lose another million in the 1990s.

America's economy is even better suited for today's rapidly changing knowledge-based economy than it was for the mass production, industrial economy of earlier times. The new bottom-up economic environment is tantamount to a giant information processing system that enhances its capacity to absorb, adapt to, and manage ongoing revolutions in technology, information, and logistics that are too dynamic and complex to be handled by a top-down system, no matter how talented its bureaucracy, government, or corporate oligopoly. The marriage of a new economy and an older American culture promises a comparative advantage that will endure.

A THOUSAND POINTS OF FINANCIAL LIGHT

THE ENERGY in the business economy is matched by a unique and remarkable world of finance capital. This realm has proven its capacity to provide the multiple sources of entrepreneurial capital needed by entrepreneurial management, thereby demonstrating its ability to meet the needs of a modern, rapidly changing, globalized economy. The "old-

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boy" financial institutions—primarily the major banks and insurance companies—proved to be less entrepreneurial, more risk-averse, and more bureaucratic than was necessary for American growth in a dramatically changing economic environment. They tended to concentrate their lending to investment-grade companies when approximately 95 percent of American companies were not investment-grade.

In the 1970s and 1980s, access to capital was thrown open by the burgeoning American middle class. In the 1970s, they watched the decline in the stock and bond markets; in the 1980s, they witnessed the focus on shareholder values and superior market performance of the Fidelities, the Alliance Capitals, and investors like George Soros. Their capacity to invest was enhanced by the ERISA pension legislation, and especially by 401(k)s, which gave some individuals the right to direct their investments. With scorecards to measure performance, middle-class Americans voted with their savings and abandoned the practice of investing their money with elite banking and insurance firms with illustrious pasts. Instead, as the American middle class gained economic sophistication, they increasingly trusted their funds to those who demonstrated a capacity to respond to change and whose relative performance could be measured by regular calculations of their gains and losses. The result was an explosion of the share of their household wealth that has gone into stocks—now 28 percent, compared with just 12 percent in 1990.

The diversification of investment outlets means that elite institutions no longer dominate the commanding heights of finance as they did earlier and still do in countries like Germany and Japan. American elite banks' involvement in both lending and managing financial assets dropped precipitously, while those of mutual funds and other managers rose correspondingly. As a result, the number of places to go for money exploded. Accompanied by financial market deregulation and financial product innovation, the stock and bond markets, mutual funds, investment managers, hedge funds, opportunity funds, high-yield funds, bridge funds, venture capital funds, and initial public offerings (IPOs) grew in amounts and varieties that vastly exceeded the total in all other countries—a veritable thousand points of financial light.

Only when money is there to back good ideas will the necessary economic synergy emerge, especially when U.S. capital markets allocate

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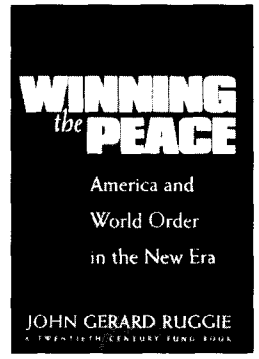

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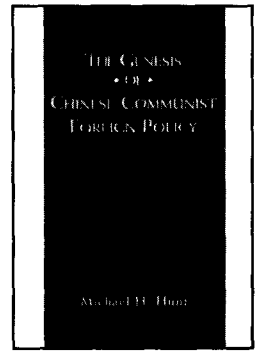

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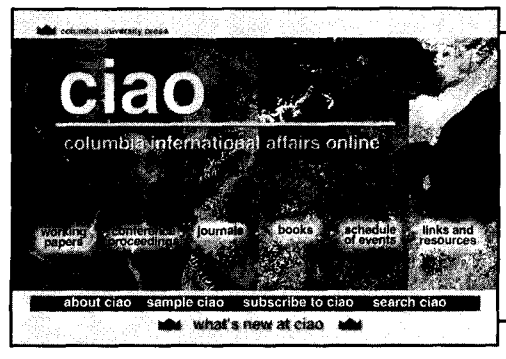

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money to firms that seem likely to earn the highest return, rather than lending to friends or relying on established corporate relationships, as is common elsewhere. That is why America is the only country that funds so many of its young, who are the most comfortable and creative with the new technologies. America's capital markets increasingly fund the future, not the past—the new, not the old.

Nothing better illustrates this than the annual investment over the past several years of $35 billion to $50 billion in IPOs and $10 billion to $15 billion in venture capital—numbers that dwarf similar investments in the rest of the world. This is not short-term capital, but long-term, risky investments. In the 1990s, the United States has funded approximately 4,000 companies, in amounts approximating $250 billion, through IPOs. All of Europe, by contrast, has funded just a few hundred new companies over the same period, in amounts that are less than ten percent of the U.S. total.

America's capital markets fund the future, not the past.

The IPO process reveals America's merit-based, diversified financial environment. Companies wishing to appeal to the market are vetted initially by one of numerous investment banks. Once that support is secured, the managers of supplicant companies go on the road, all across America, to present themselves and their business strategy to individuals representing hundreds of institutional investors, mostly mutual funds, and persuade them to invest. This is the principal way entrepreneurial capital has been found to fund young talent, new ideas, and the long-term risks associated with high-tech, high-growth, and high-concept companies. The results can be seen in NASDAQ's increase in value from about $90 billion in 1980 to approximately $2 trillion by 1998. Combined with the rate of business start-ups, these IPO and venture capital investments show an economy growing primarily from the bottom up.

The flooding of money into various financial pools is supplemented in the United States by a remarkable transparency bred in the depression days of the 1930s and more recent catastrophes like the 1980s savings-and-loan scandal. Unlike the Asians in particular, Americans know more or less what is being done with their money. Accounting systems in the United States strive for clear corporate

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information. No other country's financial system reflects such a willingness to bring financial problems to the surface rather than bury them in arcane financial documents. This allows regulators and shareholders to retain the confidence so critical to the democratization of capital.

The synergy between business and finance has helped break a pattern that has afflicted investment decisions in conventional business cycles. Previously, the fear that the boom was running out led to cuts in investment that guaranteed supply bottlenecks and ultimately inflation. This time, real spending for plant and equipment has grown three times as fast as the economy as a whole. New orders for capital goods are increasing at double-digit levels, to a postwar record of 12 percent of GDP today, compared with 7 percent in the 1980s. These expenditures are driven by intense competitive pressures, quicksilver technological change, strong earnings growth, and the falling cost of capital. The results can be seen in a manufacturing capacity that rose by only around 2 percent annually in the 1980s and early 1990s but has risen dramatically since then, by 2.6 percent in 1994, 3.5 percent in 1995, 4 percent in 1996, and approximately 5 percent in 1997. This capital goods spending cycle is a true supply-side recovery, providing an increasing capacity that is intrinsically deflationary.

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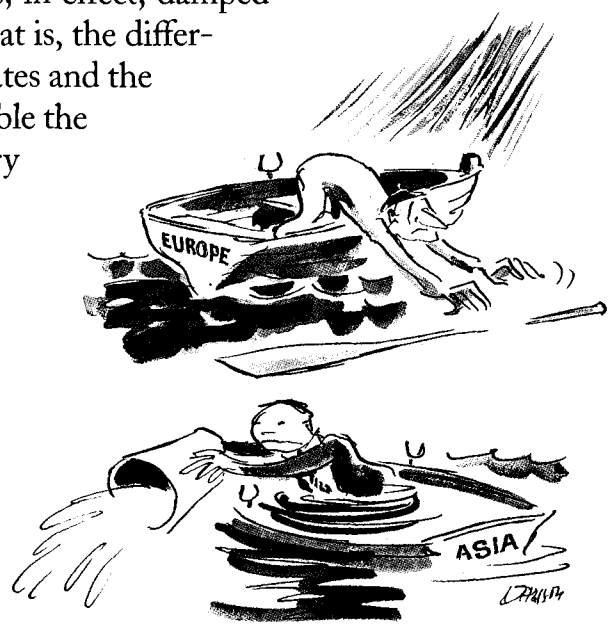
With the rise in capital investment has come an emphasis on the regenerating power of incorporating knowledge and sophisticated technology into capital goods. America was the first to realize the importance of computers and information technologies. American industry spends some $130 billion on industrial machinery but over $220 billion a year on computer and communications hardware, on top of tens of billions on software and systems development. U.S. computing capacity is growing by more than 35 percent per year and semiconductor capacity by about 30 percent per year.

One major source of this flow of investment funds is the elimination of federal deficits that reached $290 billion in the early 1990s, when the Treasury was borrowing $6 of every $10 raised in U.S. credit markets. Now the United States is enjoying a surplus that looks likely to continue as far as the eye can see. The era of the deficit is over, assisted, of course, by the slowdown in military spending after the Cold War. The contraction of the federal deficit has boosted the available savings pool, lowered nominal interest rates, and helped companies break the cycle of booms crippled by undercapacity.

This remarkable turnaround in fiscal policy has been supplemented by confidence in current Federal Reserve policy as a brake against inflation. By anchoring the yield curve for federal funds at 5.5 percent, the Fed has, in effect, damped inflation by real interest rates (that is, the difference between nominal interest rates and the inflation rate) of 4 percent—double the usual margin. Thus monetary policy has, in fact, tightened in recent years as rates were held steady or raised, while inflation continued to decline and the dollar appreciated against other currencies.



The United States is reaping the benefits of the best political climate in 50 years for the practice of such noninflationary fiscal

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and monetary policies. The structural element here is demographics—the rising proportion of our population that is retired or will be over the next several decades. The elderly and the baby boomers are making government listen to their anxieties about inflation. As some 70 million baby boomers approach retirement, they are putting their savings into mutual funds and other equities, determined to protect these savings from inflation. Their desire for a stable dollar is more politically important today than the pressure for job creation for the young, which dominated policy for most of the postwar era.

Public policy has also significantly sharpened competition and reduced inflation through deregulation—a trend that is unlikely to be reversed. Today oil, gas, transportation, railroads, airlines, and telecommunications companies have to compete or die. The steel, textile, and auto industries are no longer fully protected by tariffs and "voluntary" quotas. Even agriculture is facing deregulation.

Finally, there are the gains from a public policy that articulates not just what government does but what government does not do. In the United States, unlike Asia, the government is not involved in the formulation of industrial policy or in mandating funding or other support to specific industries or companies. Nor is there the intimacy between government and business characteristic of much of Europe. In the United States, the private sector makes the overwhelming majority of strategic and tactical business decisions. This is all to the good in a rapidly changing economic ecology in which only the markets have the capacity to process vast amounts of information rapidly enough to make the best decisions for allocating resources and developing products and services. Other dimensions of the limited role of government are reflected in the ease with which new companies can be started and new products introduced. This systemic difference between the United States and the rest of the world serves U.S. economic prospects well.

IGNORE THE CASSANDRAS

Pessimists say U.S. growth is not really so impressive and cannot be sustained. If inflation is lower, the argument goes, the United States may just be on the verge of a wage-increase-driven inflation. If U.S. productive capacity is growing, they warn, it is not growing fast

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enough. Bottlenecks and price increases lie ahead. The pessimists find discomfort even in the fact that today's productivity improvements may be understated for an information economy, rather than an industrial economy. That would mean growth is even faster, enhancing the risk of inflation.

The practical experience of U.S. business leaders suggests otherwise. They understand that the low level of inflation Americans are enjoying is self-perpetuating. With long bonds at their lowest levels since the government started to issue 30-year Treasury bonds in 1977, companies are laying down an even better future by investments in machinery and systems that will enable them to prosper without raising prices. The gains in productivity offer the chance to simultaneously increase profits and wages and decrease inflation. Business leaders assert that productivity increases are genuine and revealed in the form of rising profits, despite stable prices. If statistics suggest that productivity increases are still around 1.5 percent annually, far less than the 3 percent rises of the 1950s and 1960s, then business leaders say something is wrong with the numbers—numbers that are more relevant to an industrial economy than to a service and information economy, where so much investment goes to improve quality and speed of output.

U.S. jobs depend far more on global competition than on the business cycle.

If productivity truly is lagging comparatively, what will happen to inflation if labor begins to demand an increased share of the new wealth? It is a fair question. Low inflation and high profits could be attributable to the apparently slow growth in wages. The transitory nature of the slowdown in wage demands has been suggested in a recent study by Tara Lawn and Robert W. Rich of the Federal Reserve Bank Board of New York. They argue that lower inflation is, in fact, due not to increased productivity but to the uniquely lower pressures from wage earners. Compensation now trends higher, closer to its traditional path. So the good days may only be temporary. But how long is temporary?

Relatively low wage pressures are due in large part to job security having become more important than wage increases. In the 1990s, workers witnessed an involuntary job loss at rates double that of the 1980s, at a time when unions have declined to about one-tenth of the

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private sector work force. Everyone knows, white-collar workers included, that wages of workers in poorer countries are critically relevant in an era of global production. The "few hungry men at the gate" that Henry Ford warned would always control the level of wages are not here anymore but abroad. Psychologically, they might just as well be across the street. The wages of foreign workers are now very much a factor in corporate planning and labor reactions.

American workers understand that their employment today depends far more on the global competitiveness of their industry or plant than on the phase of the business cycle. Even in good times, workers and management are constantly conscious of waves of downsizing and restructuring and the need to cut costs. Those who survive restructuring always fret that they may not next time. In 1996, 46 percent of workers in large firms feared being laid off—twice the 1991 level, despite five years of economic expansion and a sharply lower unemployment rate. Worker anxiety can be seen in the backlash against trade with other countries, as reflected in the opposition to granting the president renewed "fast track" authority to negotiate trade deals. But worker anxiety has undoubtedly given greater flexibility to American management, and labor has accepted the need for companies to be competitive and for labor to be both adaptable and mobile—far more adaptable than Europe or Japan.

Another factor restricting the translation of wage pressure into inflation is that the demand for workers in the traditional industrial sector has been growing at the meager rate of under two percent annually—not enough to drive up wages. But in the high-tech industries where demand is strongest and wages have risen more dramatically, competition-driven improvements in design and productivity have absorbed so much of the pressure of wage increases that product prices have been falling by approximately 20 percent annually for the last five years. So wage increases have not translated into inflationary pressure.

This litany of America's economic successes may sound tinny to those who feel their lives buffeted by forces over which they have virtually no control. People are working harder than ever before. The gap between the well-to-do and the poor has been growing. The options for unskilled workers keep shrinking, as does the safety net that is supposed to protect them if they fall out of the economy altogether. Yet other

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benefits do, in fact, radiate from the flourishing economy. Young families today are two-thirds better off than their parents were at the same age. If today's material abundance feels inadequate, it is only because Americans today view as essential many things that used to be considered luxuries. But who can doubt that the quality of life has improved? Lower crime rates, dramatic reductions in the welfare rolls, more varied leisure activities, greater opportunity (even in a society renowned for equality of opportunity), record numbers of people entering colleges and universities—all feed a national optimism and sense of renewal that rides over the potholes of politics and defies predictions of calamity.

There are many explanations for this buoyant, confident mood. One is the get-up-and-go spirit that has always typified America. But surely another is prosperity. This survey of the American economy shows that this is not a transient prosperity but one that derives from a series of structural advantages that today only America enjoys. The rest of the world may improve their public policies through accelerated deregulation and prudent fiscal policy. They may reform their closed and opaque financial systems; they may embrace more fully the technological and logistical revolutions sweeping the business world; they may send their sons and daughters to business schools; they may strive to open up their more parochial business and national cultures. But America will not be standing still. If anything, American business should widen its lead over the rest of the world. France had the seventeenth century, Britain the nineteenth, and America the twentieth. It will also have the twenty-first.

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Debate

America the Boastful

Paul Krugman

WHAT HAS NOT GONE RIGHT

THE LATE 1980s were a good time for Europe: growth accelerated, unemployment fell, and dreams of European unity seemed within reach. A mood of almost giddy optimism—Europhoria—swept the continent. Even non-Europeans were caught up in the spirit. As late as 1992 the economist Lester Thurow's bestseller *Head to Head* proclaimed that "future historians will record that the 21st century belonged to the House of Europe."

So in 1987, when the Brookings Institution published a collection of papers entitled *Barriers to European Growth: A Transatlantic View,* which focused on the syndrome of slowing growth and rising unemployment that had become evident over the previous 15 or so years, many European commentators dismissed the volume as a case of fighting the last war. Europe, they insisted, was on the move; energized by the transition to a single market, it had entered a period of renewed growth and technological vigor.

In retrospect, European elation was, to say the least, premature. The structural problems that underlay Eurosclerosis had not been resolved; they had merely been masked by an upswing in the business cycle. When the next recession arrived—and there is always a next recession—it raised unemployment rates not merely to their previous peaks but,

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in most of Europe, to levels not seen since the 1930s. All in all, it was an object lesson in the difference between cycle and trend: one swallow does not make a spring, and a few good years of growth do not necessarily signal a turnaround in economic fundamentals.

While Europeans may have learned that lesson, Americans have not. Although until quite recently titles like Donald Bartlett and James Steele's *America: What Went Wrong?* typified commentary about the U.S. economy, and economic journalism was dominated by scare headlines about downsizing, after a mere two years of good news America's mood has become startlingly triumphalist. In the view of many business and political leaders America has entered the era of the New Economy, in which traditional limits to economic expansion are no longer relevant. And because America has a New Economy and the rest of the world does not, it is once more indisputably number one, and the rest of the world must adopt its values and emulate its institutions if it wants to compete.

To anyone with a sense of history, this is all deeply worrying. If pride goeth before a fall, the United States has one heck of a comeuppance in store. Yet the strengths of the U.S. economy are not merely a matter of boasting. The task is to separate the realities from the myth. What has gone right with America, and what has not?

HOW NEW AN ECONOMY?

BY ANY standard, 1997 was a very good year for the U.S. economy. GDP grew by almost 4 percent, well above the 2.4 percent average over the past 20 years. Unemployment fell to 4.6 percent, a 25-year low. Meanwhile inflation remained quiescent, at less than 2 percent.

How should we view this success? A year of fast growth, even without inflation, is not that unusual: in 1983 the economy grew by almost 7 percent, also without inflationary pressure. Yet morning in America did not signal a long-term increase in the economy's growth rate: growth over the following decade averaged only 2.4 percent annually. How can we tell whether 1997 was a similarly temporary surge or something to which we should become accustomed?

To answer this question, it is essential to take on board a bit of economics that, though rudimentary, is often ignored in public discussion:

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the distinction between growth in the economy's productive capacity and fluctuations in the utilization of that capacity—or, to put it another way, the difference between trend and cycle.

Think of the economy as a machine that can be run at variable speed. It may sometimes be possible to increase what is produced by running the machine faster; however, if it is run too fast, it will overheat. Thus while it is possible in the short run to get more output by using the economy's capacity more intensively—especially if the economy starts from a point where capacity is severely underused—over the long run the only way to achieve a sustained increase in production is to increase what the machine is capable of making, that is, to increase the amount it can produce at a given speed.

This discussion may sound abstract, but it is possible to make a fairly clear distinction in U.S. economic data between growth due to fuller use of existing capacity and growth due to expanded capacity. The unemployment rate turns out to be a pretty good indicator not only of the utilization of the labor force but of the utilization of economic capacity in general. There is a remarkably good (though not exact—this is economics, not physics) rule of thumb known as Okun's Law, which relates changes in the economy's utilization of capacity, as measured by the unemployment rate, to its growth rate. Here is how Okun's Law works. In a year in which the unemployment rate does not change, the economy typically grows about 2.4 percent; every percentage point decline in unemployment adds 2 percent to that growth rate (while every percentage point rise subtracts 2 percent). That 2.4 percent growth when the unemployment rate is constant is the growth in the economy's capacity; the extra growth when the unemployment rate declines (or growth shortfall when unemployment rises) represents a change in the utilization of that capacity.

Okun's Law works well in accounting for the growth surge of 1983. As the economy recovered from the recession that had raised unemployment to a postwar high of 10.7 percent in the fourth quarter of 1982, the unemployment rate fell by 2.2 percentage points. The rule says that the economy should therefore have grown by 2.4 + (2 x 2.2) = 6.8 percent—very close to the actual growth. The same rule also works well for last year: since the unemployment rate fell from 5.3 percent in late 1996 to 4.7 percent in late 1997, we should have expected

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growth of 2.4 + (2 x 0.6) = 3.6 percent—close enough to the actual 3.9 percent to be well within the normal fuzziness of economic statistics.

The point of these exercises in arithmetic is that because the same rule that accounted for fluctuations of growth around its long-run average 15 years ago continues to work today, there is no reason to believe that the rate of growth of the economy's capacity—and therefore its long-run growth rate—has accelerated.

The economy's long-run growth rate has not accelerated.

What may have changed is the ability of the economy to make use of capacity without getting overheated. Until a few years ago, typical estimates suggested that any unemployment rate below about 6 percent would lead to a gradual but inexorable acceleration of inflation. But here we are with an unemployment rate of less than 5 percent, and with prices still stable. Does this situation represent a fundamental improvement in the economy's ability to deliver full employment?

The answer is definitely ambiguous. Some have argued that tight labor markets no longer cause inflation because international competition now prevents companies from passing on increases in wages or other costs in higher prices. However, there is no evidence for this view (which is dubious in any case for an economy dominated by non-traded services). Rather, the proximate explanation for low inflation in recent years has been that costs themselves have, for a variety of reasons, risen less than one might have expected given how hot the economy is running. The most important restraint on inflation has been a squeeze on worker benefits, mainly due to the switch to managed health care. In the last two years the strength of the dollar and the economic woes of Asia have also pushed down import prices, helping keep inflation low. But for these special and necessarily temporary factors inflation would probably already have started to show clear signs of returning. Wage increases have been accelerating steadily since 1995, and, with the shift to health maintenance organizations more or less complete, benefits have started to rise again. Sooner or later the need to keep inflation in check will probably force the Federal Reserve to allow (or engineer) a rise in the unemployment rate.

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Nonetheless, the sustainable unemployment rate has probably fallen. Weaker unions, reluctance on the part of workers to demand wage increases in an era of downsizing, reluctance of employers to grant such increases in an era of greater competition, and a more flexible labor market due to the growth of temporary work may all imply that 5 percent unemployment is not what it used to be. Taking recent experience into account, a middle-of-the-road estimate of the unemployment rate that is now consistent with stable inflation would be somewhere between 5 and 5.5 percent. The administration uses 5.4 percent for its budget estimates; it is possible, though difficult, to make the case for 5 percent.

In sum, despite the rapid growth of 1997, nothing in recent experience suggests that the U.S. economy is capable of more than about 2.5 percent growth in an average year. It is, however, likely that the sustainable unemployment rate has fallen, perhaps as much as a percentage point. Remembering Okun's Law, this means that the amount the U.S. economy can produce in an average year is at most about 2 percent higher than we thought it was. This is good news—2 percent of U.S. GDP is more than $150 billion—but hardly a revolutionary improvement.

Of course, low unemployment has benefits that go beyond mere economics. A tight labor market disproportionately benefits marginal workers, those who tend to be last hired, first fired; for those attempting to take the first step out of the underclass, the difference between 6 percent and 5 percent unemployment may be large indeed. But in terms of the economic might of the United States and its ability to generate wealth (and perhaps to convert that wealth into power), the news in recent years has been relatively small change.

Or at least that is what the numbers say. But might the numbers be wrong?

A HIDDEN BOOM?

THE U.S. economy's productive capacity is, by definition, the number of employable workers multiplied by productivity, or output per worker. The reason why the growth in that capacity seems rather slow is that productivity, according to official estimates, has risen at a modest pace—just over one percent annually during the 1990s to date, a rate similar to that during the previous two decades.

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But many observers do not find these official estimates credible. After all, these are the days of reengineering and total quality management, of the Internet and intranets, an era in which many businesses boast of having achieved dramatic increases in productivity. Surely, the believers in a New Economy insist, so many tales of a productivity revolution cannot be mere hype, and surely the reality of much more rapid productivity growth than the numbers describe is validated by the economy's unexpected ability to grow rapidly without inflation.

To parse these claims, it is essential to distinguish between two questions. One is whether official estimates are missing a lot of productivity improvement, to which the answer is yes, they are—but they always have. The other is whether the unmeasured productivity gains that are surely taking place can explain the economy's good measured performance, to which the answer is definitely no.

Few economists question the proposition that official measures tend to understate true growth in a technologically progressive economy. In essence, official measures of productivity are always backward-looking: they ask how much more of a given good a worker can produce this year than he could last year. But what if a worker produces something that simply was not available last year? How do you compare the productivity of electricians with that of lamplighters, of auto workers with that of carriage makers, of doctors prescribing antibiotics with that of those who had little to offer beyond aspirin and sympathy? Because such qualitative improvements are inherently difficult to put into an index, productivity and economic growth in general have surely been understated throughout the past century and a half.

But are they more severely understated now than before? Certainly we talk more about technological progress than we did a couple of decades ago, but that may have more to do with who does the talking than with the progress itself. Here is how the Berkeley economist Bradford De Long responded to one New Economy advocate in the December 9, 1997, issue of the on-line publication *Rewired:*

> Kevin Kelly [the executive editor of *Wired,* writing in the September 1997 issue] has made an elementary mistake. He remembers the goods of the industrial revolution from automobiles to washing machines,

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railroads to container ships to airplanes to radios—from his childhood. So he assumes that they must have always existed, and that the pace at which they changed must have always been glacial.

But revolutions in productivity in the economy's shifting set of leading sectors have been ongoing since 1760 or so, the beginning of the industrial revolution. In fact, that's why the age starting in 1760 or so is *called* the age of the industrial revolution.

Microelectronics as one of the leading sectors of technological change—microelectronics as an industry—is new to our generation, but productivity advances in leading sectors that are fast enough to be called industrial revolutions have not been news for two and a half centuries . . .

So what, then, *is* new about our post-industrial economy? What is new is that for the first time since the invention of printing, information processing and distribution has become one of the leading sectors. Previous leading sectors changed the conditions of the lives of weavers, spinners, transporters, framers, blacksmiths, and so on. Our leading sectors are changing the conditions of life of those who use information to direct enterprises—managers—and they are also changing the conditions of life of those who use information to decide what to buy—consumers. Perhaps most of interest, however, society's information processors and distributors include its intellectuals.

So we intellectuals are, quite naturally, incredibly excited. And we are very, very articulate.

In other words, the belief that official statistics must be doing an especially bad job of tracking technological progress right now is grounded, at base, in a lack of historical perspective.

Of course, when businessmen enthuse about the supposed technological revolution in America, they also tend to enthuse about the institutions that supposedly make that revolution possible: an entrepreneurial culture, capital markets eager to back risky start-ups, labor markets that do not burden employers with annoying regulations (or unions), and so on. They also congratulate themselves on having become lean, mean, and competitive.

Perhaps the main point to make about this institutional optimism is that it involves a lot of implicit theorizing. Do we really know that highly flexible capital and labor markets are such wonderful things? As recently as five years ago the conventional wisdom was exactly the opposite: Japanese companies, in particular, were supposed to be superior to their Western counterparts because they were insulated from the

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pressure of capital markets and hence able to take a long view, and because inflexible labor markets, also known as the lifetime employment system, made them better at accumulating human capital. Why such a reversal of opinion? The answer, presumably, is that now we can see that American institutions foster higher productivity—except that the productivity surge is itself merely hypothetical, invisible in the data.

While a sense of history might lead one to be agnostic about claims of a productivity revolution in the United States, doesn't the experience of high growth without inflation show that something new and good is happening? Well, no. For one thing, the quiescence of inflation in the face of declining unemployment seems to be fully explicable in terms of other, less glamorous factors—mainly the sluggish growth in wages and benefits. Furthermore, a technical point is critical here: official estimates of productivity are constructed using the same data that are used to construct estimates of GDP. Indeed, official estimates of productivity are nothing more than GDP per worker. Any understatement of one must therefore imply an equal understatement of the other—hence unmeasured productivity growth cannot be responsible for the high measured GDP growth.

This seems to be a surprisingly difficult point to grasp. A parable may help. Imagine a New Economy advocate who discovers that he has a problem with his car. Whenever he drives too fast—whenever the needle on his speedometer goes above 40—the car develops a dangerous shimmy. So he carefully drives the car to his mechanic, never letting the needle go past 39. Alas, the mechanic informs him not only that he cannot fix the shimmy, but that the car has another problem: something is wrong with the speedometer, which is consistently understating the car's speed. Indeed, when the needle is at 40, the car is actually going 55. To the mechanic's surprise, the New Economy advocate is delighted with this news: "What you're telling me is that the shimmy doesn't start until I'm actually going 55. That means I can drive home 15 miles an hour faster than I drove here!"

Nobody would make this mistake in daily life, but many New Economy advocates make exactly the same mistake with regard to productivity and growth. Last year the U.S. economy grew by 3.9 percent, which is about 1.5 percent more than its long-run sustainable rate. But New Economy enthusiasts argue that productivity growth is severely understated. And suppose, they say, that productivity is actually grow-

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ing 1.5 percent faster than the numbers say; then the sustainable rate of growth of the U.S. economy is really 3.9 percent, not 2.4. And doesn't that mean that last year's growth did not put any strain on capacity after all—which explains why it did not cause inflation (the shimmy)?

The point should now be obvious: since measured productivity growth is simply GDP per worker, if productivity has been understated, so has GDP, by exactly the same amount. So if productivity growth was really 1.5 percent higher than the numbers say, even though the sustainable rate of growth would be 3.9 percent, the economy would really have grown by 5.4 percent—and the failure to show signs of inflation is as much (or as little) of a puzzle as ever.

That means that the recent ability of the United States to combine high measured growth with low inflation provides no evidence for the putative hidden boom in productivity. Even if official statistics understate true productivity increases, the economy's rapid measured growth over the last two years has sharply increased its capacity utilization—just as driving with the speedometer needle at 55 means driving faster than with the needle at 40, even if the speedometer consistently understates your true speed. So invoking unmeasured productivity growth does not help explain why the acceleration of inflation that normally occurs when capacity utilization is high has not yet materialized; that good news must and can be explained by other factors. Conversely, the fact that inflation has remained low despite high growth offers no evidence in support of claims of a hidden productivity boom—if A can't cause B, then observing B provides no evidence in favor of A. The supposed productivity revolution remains purely hypothetical.

Hidden productivity growth cannot explain low inflation.

What, then, is left of the New Economy? We have had a favorable turn in the business cycle, abetted by some temporary factors that have helped keep inflation down, and probably also by shifts in the labor market that have reduced the bargaining power of workers and therefore allowed fuller employment without accelerating wage increases. The New Economy, in short, looks a lot like the Old Economy. It has about the same long-run growth rate but can run at slightly lower unemployment. Things could be worse, but nothing fundamental has changed—the amount of good news is not enough to justify the triumphant rhetoric one now hears so often.

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LAGGING RIVALS

IF THE U.S. economy is not doing as well as advertised, why the sense of renewed American preeminence? One answer may be that other economies—in Europe and in Asia—have fallen short. In a world of stagnation and crisis, a country that continues to make even modest progress may be entitled to some self-satisfaction.

There is no question that much of the world has disappointed expectations that were widely held only a few years ago. The days when Thurow could confidently predict, "Over the next five years Europe will move to full employment," and the journalist James Fallows could declare, in the January 1994 *Atlantic Monthly,* "Like it or not, we live in the world that Asian success stories have shaped. We need to figure out how to compete in it," seem distant now. But just as pronouncements of American triumph turn out, on close examination, to be overstated, so do the dismissals of European and Asian prospects that one now hears. Let's take a quick tour of the world to examine how matters actually stand.

Europe. Compared with the optimism that prevailed at the beginning of this decade, Europe's economic performance has indeed been a huge disappointment. Particularly distressing to those who place their faith in European unity has been the failure of measures aimed at reinforcing that unity—the creation of a single market, the drive toward a common currency—to jump-start the continent's economy. Indeed, a good case can be made that the efforts of European countries to meet the criteria for entry into the European Monetary Union (EMU) at the end of this year have actually aggravated the problems of slow growth and unemployment.

Will the achievement of EMU transform the situation? Almost surely not. There has been a massive and occasionally bitter debate over whether on economic grounds Europe really should have a single currency. EMU advocates have failed to make a convincing case for large gains, but EMU opponents have also failed to make a conclusive case for large losses. One thing that seems clear, however, is that establishing a single currency will have little if any impact on Eurosclerosis: the forces that keep unemployment high and job creation low will be as strong on January 2 of next year as they are today. My own amateur prediction is that this persistence will lead to a period of great political disillusionment: having spent many years suffering

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under the disciplines of the Maastricht treaty, Europe will arrive at the promised land and find that it looks an awful lot like the desert.

That said, in some respects the European economy continues to show considerable resilience. Given the general sense that the United States has once again seized the technological high ground, it is surprising to learn that the already small gap in productivity between the United States and advanced European countries has continued to narrow during this decade, and has indeed become so small as to be within a reasonable margin of error (see table). And while slow growth in employment means that per capita income has not converged as rapidly as productivity, even there most advanced countries have continued to narrow the gap.

The sense that the United States is on top of the world exaggerates a few good years.

At a more impressionistic level, it is also far from clear that Europe really is lagging behind in technology. True, the United States dominates the high-profile sectors of the moment, microprocessors and computer operating systems. But the main economic payoff from these technologies lies not in their production but their application, and here the picture is mixed. The United States has taken more rapidly to the Internet and e-mail than most European countries, largely because of low telephone charges, although the most wired country in the world is, surprisingly, not the United States but Finland. Europeans, on the other hand, have technologically superior cellular phones. Which matters more for business? Never mind; the point is that Europe and the United States are operating at essentially the same technological level, with each side of the Atlantic having a small edge in some things.

Europe, in short, has a poorly functioning labor market, as it has for the past generation, and as a result has a dreary employment picture. But on other fronts the gap between Europe and the United States has narrowed or vanished, not widened. The only sense in which Europe has fallen behind is its failure to live up to unrealistic Europhile expectations.

Japan. Japan, unlike Europe, has underperformed not merely relative to the expectations of its naive admirers but compared with almost anyone's forecast. An economy that grew at an annual average rate of four percent during the 1980s has grown hardly at all since 1991. What went wrong?

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The truthful answer is that nobody quite knows. The odd thing about Japan's economic stagnation is that many of the strengths that powered the economy's growth during the previous 40 years seem intact. High-quality manufacturing, innovative product design, even the famed skill at exporting seem still to be there. Japan, remarkably, managed to run trade surpluses during the mid-1990s, even though the yen was at a level that seemed to make the country's products radically uncompetitive.

In some ways Japan seems to resemble nothing so much as the United States during the 1930s: a highly productive industrial society that managed to stumble into a financial crisis (the stock market crash of 1929, the bursting of the bubble economy in the early 1990s) and has not been able to get itself restarted despite near-zero interest rates and intermittent efforts to pump-prime the economy with deficit spending. Part of Japan's problem is rooted in a banking system that cannot function effectively because it has never come to terms with its bad loans; part of the problem also lies in a service sector that, because it is overregulated and lacks competition, cannot supply the investment demand the economy needs to get moving again. Japan's once-fabled Ministry of Finance also shares much of the blame. It has consistently raised taxes whenever the country has shown signs of recovery, seemingly determined to keep the economy depressed. Whatever the nature of the malady, Japan's stagnation unquestionably makes the United States look good by comparison.

But we should bear in mind the comparison with the United States in the 1930s: the strengths of its economy then were real, and once a recovery began in earnest it was the Depression, not the Roaring Twenties, that began to look like an aberration. Japan may well be back.

TABLE

COMPARISONS OF INCOME AND PRODUCTIVITY

REAL GDP PER CAPITA, U.S. = 100

	1989	1996
JAPAN	75.5	81.0
FRANCE	73.6	71.6
GERMANY	78.3	80.2

REAL GDP PER EMPLOYED PERSON, U.S. = 100

	1989	1996
JAPAN	73.9	76.4
FRANCE	90.2	90.6
GERMANY	84.9	91.4

REAL GDP PER HOUR WORKED, U.S. = 100, 1996.

JAPAN	70.9
FRANCE	100.4
GERMANY	106.8

SOURCE: "Comparative Real Gross Domestic Product Per Capita and Per Employed Person, Fourteen Countries, 1960-1996," (unpublished) U.S. Department of Labor, Bureau of Labor Statistics, Office of Productivity and Technology, February 1998, Tables 2 and 4, p. 11. On-line, U.S. Department of Labor, "Foreign Labor Statistics" World Wide Web page.

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Asia. Rarely in the course of economic events has a region's reputation suffered as severe a reversal as that of Asia's emerging economies since last summer. Events are now moving too quickly to be sure how far and deep the crisis will reach, although it has already exceeded anyone's worst expectations. The best available diagnosis of the crisis is that it was made possible by runaway Asian financial institutions that in effect gambled with other people's money, and that the inevitable failure of many of them was hastened and reinforced by a circular process in which collapsing asset values undermined banks, and an imploding banking system not only further depressed asset values but disrupted the normal functioning of business. Meanwhile, foreign investors, whose excessive optimism had helped create the bubble, ran for the exits. The success of International Monetary Fund–sponsored stabilization plans is still in the balance.

While the scene has been astonishingly grim, however, Asia's present failures need to be viewed with as much perspective as its past successes. An economy may suffer a severe financial crisis, then recover and grow as rapidly as ever. In fact, the susceptibility of an economy to financial crises and its ability to deliver sustained growth in general have little to do with each other. The United States economy between the Civil War and World War I was notoriously crisis-prone. Nor were catastrophes like the Panic of 1873 pure accidents: they were made much more likely by a business and political culture in which petty things like scrupulous accounting were disdained, wholesale corruption was a matter of course, and many business empires were built on the strength not so much of productive efficiency as of political connections. Yet despite a steady stream of scandals and the occasional devastating panic, the United States rose over those years to the position of economic preeminence that it now, rather prematurely, claims to have recaptured. In short, emerging Asia will be back.

AMERICA: FIRST AMONG EQUALS

SUPPOSE THAT you had made a realistic assessment of the economic prospects of the world's major economies circa late 1992—say, at the time of President-elect Bill Clinton's famous economic summit in Little Rock. You would have noted that the one-time dominance of the United States—that postwar peak of influence when America

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produced as much as all other market economies together, when American technology was superior in almost every industry—had long since passed. Instead, we were in a world in which Europe, Japan, and the United States were all more or less on the same technological level and in which the economy of Europe as a whole was about the same size as that of the United States. But the U.S. economy was still larger than that of any other country, and it seemed likely to remain so for at least several decades. Europe was growing no faster than America. Japan was growing faster (4 percent versus 2.5 percent), but since its economy was less than half the size of America's, it would take more than half a century to close the gap even if that growth differential persisted. The only way the United States might be displaced as the world's leading economic power would have been for Europe to form a true federal union (which would have given it a political weight comparable to its already huge economic weight), something that looked almost as unlikely in 1992 as it does now.

How much has that assessment changed in the five years since? Hardly at all. Certainly there has been no revolutionary improvement in the performance of the United States. The U.S. economy is doing better than most economists expected, but as we have seen, the good news, while real, is fairly modest. Europhiles do have grounds for dismay, but mainly because their expectations five or six years ago were unrealistically high. Only in Asia has there been a true reversal of fortune, but it is too soon to count emerging Asia out, and even Japan may yet stage a recovery.

None of this is meant to suggest that the United States is in any sense on the verge of crisis; its economy does seem fundamentally sound. But the current sense that the United States is on top of the world is based on a huge exaggeration of the implications of a few good years here and a few bad years elsewhere. Let there be even a mild recession in the United States, a moderate recovery in Europe and Japan, and a rebound in emerging Asia, and talk of the return of American dominance will start to sound silly indeed. Future historians will not record that the 21st century belonged to the United States.

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Americanizing Asia?

Donald K. Emmerson

FOLLOW THE LEADER?

WHATEVER ITS duration and outcome, the Asian financial crisis will be remembered for destroying the conventional wisdom that East Asia's economies would prosper indefinitely. Still in question are the political lessons that Asians will draw from the crisis. How much, for example, will political freedom be valued as a necessary corollary to sound economic performance? Or will those who argue that sound economic management is the political key prove persuasive? And will a "Confucian" version of the discredited "Asian values" thesis find adherents?

The crisis began on July 2 of last year when the Thai government ceased wasting foreign reserves on a defense of the baht and allowed it to fluctuate versus the dollar. The resulting "managed float" immediately proved unmanageable. The baht's fall triggered a regional currency and equity cascade. As it swept from Bangkok through Kuala Lumpur, Manila, and Jakarta to Seoul and Hong Kong, upbeat exponents of "Asia rising," "the East Asian model," and an imminent "Pacific century" barely had time to edit these phrases from their screens and diskettes.

A few early warnings had been sounded. The World Bank had worried about trends in Thailand before July. And some skeptics, like the MIT economist Paul Krugman, had doubted that East Asia's breakneck economic pace could be sustained. Nevertheless, most analysts were sanguine and slow to reconsider. But in hindsight it is clear that for much of Asia 1997 was an *annus horribilis*. The crisis appeared to have abated in some countries earlier this year, notably

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Thailand and South Korea, but it worsened in Indonesia, Southeast Asia's largest economy. These days most observers expect the crisis, or its aftershocks at any rate, to endure into 1999 if not beyond.

In 1997 five East Asian stock markets—those of Indonesia, Malaysia, the Philippines, South Korea, and Thailand—lost more than three-fifths of their value in dollars. Economic, environmental, and health problems due to Indonesia's prolonged drought and forest fires compounded these shocks in maritime Southeast Asia. Meanwhile, Japan's economy remained in doldrums that have lasted seven years, longer than any other lapse in that country's growth since World War II. As for China, financially hemorrhaging state enterprises continue to threaten stability across the Middle Kingdom.

The ramifications of East Asia's crisis go beyond the region. And they amount to more than the question the media keep asking: "Who else will catch the Asian flu?" In the United States, the rupturing of optimism about East Asia seems to tip the balance between the two most widely discussed positions about the dynamics of power in the post–Cold War world. The two sides of this debate can be termed divergence and convergence. Divergence holds that foreigners are challenging American dominance by asserting non-American models in politics, economics, and culture. On the other side, convergence suggests that foreigners are paying tribute to the supremacy of the United States by imitating its superior ways. Events in East Asia in 1997 appeared to weaken the case for divergence and, at least by default, strengthen the argument for convergence.

The Asian financial crisis was unkind to at least three versions of divergence. First, it ravaged the credibility of a supposedly distinctive East Asian, or Japanese, model of economic growth based on cooperation between conglomerates—Japan's *keiretsu*, South Korea's *chaebol*, Indonesia's *konglomerat*—and astute government officials. Collapsing Asian markets revealed the crony capitalism beneath the surface of East Asia's "developmental state." Second, the Asian crisis reduced the chances of a trans-Pacific "clash of civilizations." Falling growth rates and mounting losses in dollars jeopardized the resources and self-confidence that leaders of the Sinic world would need were they to challenge the West. Third, the crisis damaged the Asian leg in the tripod model favored by those who expected power after the Cold

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War to coalesce around three regional blocs, each with its respective hinterland and hub: East Asia fanning out from Tokyo, the Americas centered on Washington, and Europe led from Brussels. "Head to head to head" competition became less plausible as the Asian head became less formidable.

"Head to head to head" competition became unlikely as the Asian head became less formidable.

It would seem logical that the Asian crisis should have buoyed the proponents of convergence. American observers especially were prone to believe that just as the fall of the Berlin Wall in 1989 had vindicated the American political model—liberal democracy—so the fall of Asia's markets in 1997 proved the wisdom of the American economic model—free-market capitalism. Cultural pride tinged with schadenfreude appeared as well in the charge that East Asia's failure to maintain rapid economic growth had proved the impotence of so-called Asian values. And with Asian values out of the way, what was left but the goodness and power of the capitalist and democratic virtues undergirding American success?

Yet it is presumptuous to think that the crisis foretells Asian acceptance of American ways—that Americans can now truthfully sing, "We are the world." First, East Asia's diversity—historical, cultural, political, economic—ensured that the crisis would affect each country differently. And that has meant different explanations as to why the trauma occurred and what still needs to be done. For Malaysian Prime Minister Mahathir Mohamad, to cite a vocal example, anything-goes American capitalism was not the solution. It was the problem. Blaming the crisis on arbitrageurs and hedge fund managers such as American financier George Soros, Mahathir proposed global controls on money trading that appalled Washington.

Second, there was a difference between obligation and willingness. Even if policymakers could agree on the empirical validity of Margaret Thatcher's famous dictum about free markets—"There is no alternative," or "Tina"—that did not imply a consensus that there should be no alternative. Tina might be unavoidable, but that did not make her good. And this difference between is and ought means that at least some Asians will continue to seek what Tina forbade: alternatives to unregulated markets and the vulnerability and instability that comes with them.

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Third, the American model is hardly monolithic, and the issue of how to resolve the Asian crisis has become contentious among Americans themselves. On the same page of the *Wall Street Journal*, one expert called for higher taxes and lower spending while another advised the opposite. A third recommended doing nothing at all. Especially controversial have been the International Monetary Fund's efforts to help resolve the crisis. Deputy Treasury Secretary Laurence Summers, for instance, defends the IMF and its prescriptions as crucial to Asia's recovery. But Harvard economist Jeffrey Sachs claims it has made matters worse, while former Secretary of State George Shultz recommends its aboliton. Who can say which of these men stands for the real American model?

Fourth, America's use of the IMF to respond to the crisis created inconsistencies between theory and practice—between free-market ideology and the available remedies. The IMF's members are not corporations but states. But the crisis itself has been driven not by public debts but private ones, incurred by Asian banks and firms. The government-to-government nature of the IMF's interventions bolstered the economic significance of the state. And the opacity of the IMF's own confidential meetings and agreements did not jibe with its case for greater transparency in Asian accounting practices.

Fifth, Washington's decision not to contribute directly to the August 1997 IMF package for Thailand rankled Southeast Asians. Few were persuaded by Washington's defense that the United States had been indirectly helpful by virtue of its long-standing support for the IMF. Knowledgeable Southeast Asians were concerned by what many of them saw as congressional indifference, if not hostility, toward helping the region recover. They pointed to the inability of the Clinton administration to quickly persuade Congress to authorize additional financing for the IMF. And that inability reduced their willingness to believe that IMF conditions amounted to a specifically American model whose adoption would reap American awards.

But if Asians were not converging on an American model, they were under mounting pressure to believe that freer markets and freer politics could have prevented the crisis in the first place, or at least mitigated its effects. That pressure had many sources and forms, ranging from shorted currencies and capital flight to domestic protest and foreign advice.

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THREE SUCCESSES AND A FAILURE

AMERICANIZATION ASIDE, the differing courses of the crisis in different countries did appear to support the prescription of political freedom as a cure for East Asia's economic ills. Especially crucial to this judgment were three successes and a failure: Taiwanese resistance, Thai and South Korean recoveries, and Indonesian collapse.

No major East Asian economy with a convertible currency was rattled less by the crisis than Taiwan. In dollar-indexed terms, its stock exchange shrank a mere 5 percent in 1997 before gaining 10 percent in 1998 through March 17. Two blips, one down, one up, left this market about where it had been. In contrast, over the same two periods, the Thai bourse plunged 76 percent before soaring 73 percent. That wild ride made Bangkok's consecutively the worst-and best-performing of the 33 exchanges tracked daily by the *Wall Street Journal*. On Seoul's volatile equity market, the drop and rise were nearly as steep—down 69 percent in 1997, up 58 percent in early 1998.

Taiwan, Thailand, and South Korea, all former autocracies, have made remarkable though uneven progress toward liberal democracy. Indonesia has not. Not only was the authoritarian regime in place since 1966 still unreformed, but in March its 76-year-old architect, Suharto, already the longest-serving head of government besides Fidel Castro, got himself named president for another five years, despite his country's last-place finish in the race to exit the Asian crisis. None of the 33 tracked markets had done worse than Jakarta's. Sold and shunned by foreign and domestic investors, in 1997 and early 1998, respectively, that pariah bourse lost 64 percent of its dollar value, then 42 percent of what was left.

These events support the economic case for political freedom and accountable rule. Particularly striking was how Thailand and South Korea handled the issue of national leadership and its replacement. In Thailand, without political freedom, the incompetent coalition government of Prime Minister Chavalit Yongchaiyudh could not have been discredited. Instead, Thais could and did blame Chavalit and his ministers for failing to prevent and then worsening the economic crisis. In November Chavalit resigned and was replaced by Chuan Leekpai. Chuan's popularity allowed him to place expert technocrats in key ministerial positions where they could implement

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ARCHIVE PHOTOS

Playing along or playing games:
Suharto greets U.S. special envoy Walter Mondale, March 3, 1998

necessary reforms. Confidence in the economy began to revive. A month later South Korea changed leaders too. Blame for the tottering economy had made incumbent President Kim Young Sam, like Chavalit, deeply unpopular. The December election of Kim Dae Jung to replace him amounted to a mandate for reform. As in Thailand, confidence in the new government and its ability to repair the economy burgeoned.

Thailand not only changed prime ministers midstream, it changed constitutions too. The new document augured political reform, at least on paper. Under one provision, no one can serve as a member of parliament and the cabinet concurrently. That change might seem minor, but politicians previously borrowed vast sums to buy votes, get elected to parliament, become part of a ruling coalition, and wrangle a cabinet post, and used the office to raise under-the-table funds to pay off political creditors and buy more votes in the next election.

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Some 20 billion baht, roughly $800 million, was poured into the November 1996 election. That mixing of finance and politics helped weaken the Thai economy on the eve of its ruin the following year. By forcing ministers to give up their legislative seats in parliament, the new constitution is intended to help separate money from politics.

But even if liberal democracy can be said to strengthen an economy's ability to cope with adversity, that is not necessarily an argument for adopting the American political model. Democratic but politically divided governments in Seoul and Bangkok were implicated in failing to prevent or contain the crisis in 1997. Partisan bickering and deadlock made reform more difficult in both places. And who can say how long President Kim's and Prime Minister Chuan's honeymoon periods will last before politics as usual sidelines the chance for a concerted national effort to restructure their economies? No wonder Kim discourages talk of South Korea having "turned the corner." Facing an opposition majority in parliament that has already rejected his choice for prime minister, he needs a sense of urgency to foster consensus.

JUST ADD DEMOCRACY?

KIM DAE JUNG blames the Asian crisis squarely on authoritarian rule. "In every country in Asia, including Korea," he has said, "the major reason for [economic] failure was lack of democracy." The data in the table do not directly test this assertion, but they do relate the economic resilience of nine East Asian countries, measured by how much their equity markets shrank in 1997-98, to the degree of political freedom enjoyed by their populations in 1996, based on widely used estimates.

Among these nine East Asian economies, political freedom is not consistently associated with economic resilience. Yet there is a clear if broken trend toward more freedom being linked with more resilience. The exceptions are South Korea, Thailand, and the Philippines, which have been economically less resilient than their levels of political freedom would lead one to expect. Also, Singapore was more than twice as resilient as Malaysia, despite having the same relatively low level of freedom. Nevertheless, the pattern is suggestive: Other things being equal, the economies best able to withstand the present crisis may prove to have been those with more political freedom.

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Yet liberal democracy is not a magic bullet. The evidence in the table is compatible with other hypotheses. A culturalist, for example, would note that the five most resilient places on the list—Japan, Taiwan, Hong Kong, Singapore, and South Korea—were also those most indebted to China historically or demographically, that is, by tradition or migration. So although the crisis has buried the belief that Asian values guarantee economic success, the race to recover from the shocks of 1997-98 could resurrect a Confucian version of the same faith.

TABLE

DOES FREEDOM BRING ECONOMIC RESILIENCE?

	POLITICAL FREEDOM (1996)	ECONOMIC RESILIENCE (1997-98)
NORTHEAST ASIA:		
JAPAN	1.5	-10.5
TAIWAN	2.0	-12.4
SOUTH KOREA	2.0	-47.0
HONG KONG	3.0	-19.0
SOUTHEAST ASIA:		
PHILIPPINES	2.5	-52.7
THAILAND	3.0	-49.1
SINGAPORE	4.5	-31.5
MALAYSIA	4.5	-64.7
INDONESIA	6.0	-78.3

NOTES: Political freedom is scaled from 1 to 6; lower numbers indicate more freedom. Economic resilience is the percentage change in the value of a country's stock market between March 1997-98 (dollar-indexed); higher numbers indicate more resilience.

SOURCES: *Freedom Review*, 28: 1 (January-February 1997), p. 26; Bryan T. Johnson, Kim R. Holmes, and Melanie Kirkpatrick, *1998 Index of Economic Freedom* (Washington D.C. and New York: The Heritage Foundation/*The Wall Street Journal*, 1998); "Dow Jones Global Indexes," *The Wall Street Journal*, March 18, 1998, p. C14.

Also, excluding South Korea, the northeast Asian economies fared better than those of Southeast Asia. That could reflect distance; the crisis started in Thailand. But it also could imply the effectiveness of sheer wealth as a defense against attacks on a country's markets: in 1996 each of the three northeast Asian economies that would turn out to be the most resilient—Japan, Taiwan, and Hong Kong—held more foreign exchange on reserve than any other economy on the list. Moreover, all the northeast Asian populations enjoyed higher average incomes than any of the Southeast Asians except in Singapore.

In any event, the economic prowess of democracy should not be overdrawn. A comparison between South Korea and Singapore, for example, does not confirm Kim's sweeping belief in lack of democracy as the major reason for the economic setback in every country in Asia. In 1997-98 the value of South Korean stocks was set back more in dollar terms than Singaporean equities, despite the greater lack of political freedom in Singapore.

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In his own allocation of blame for the Asian crisis, Singapore's Senior Minister Lee Kuan Yew has suggested that what distinguishes the unscathed from the damaged is not political democracy but good governance of the economy. Singaporeans, Lee said, are not champions of human rights or democracy, "but we are very fastidious in the way in which we run our business, and on financial matters we are completely aboveboard." Lee also in effect acknowledged that not all "Asian values" are constructive. "One of the weaknesses of Confucianism," he noted, is nepotism. The economies least able to resist the crisis are those where nepotism—"the bane of East Asian countries," in his words—is most entrenched.

More than ever, Suharto and his family have become the problem.

But the views of Kim and Lee are more compatible than they first appear. Electoral democracy can undermine good governance in the absence of the rule of law. And good governance in a liberal democracy requires public servants who are insulated from the blandishments of special interests and the passions and whims of momentary majorities. Democracy as such did not damage the integrity of the Thai central bank and its ability to avoid the collapse of the baht in July 1997. But the connection between money and politics at the heart of Thai democracy did.

This judgment is in no way an argument against holding elections to ensure accountability. It is an argument for combining electoral accountability with rights and freedoms under the rule of law. One more practice, which none of these ingredients guarantees, is also necessary: good governance, in the sense of entrusting a few particularly sensitive functions to agencies whose ability to serve the public interest is improved by limited accountability to elected politicians.

In the United States, the president cannot appoint the head of the Federal Reserve. Presidents appoint its governors, but to 14-year terms; governors outlast presidents. Governors also elect the chair of the system, who is responsible to them. The point is clear, and in a particular sense it is antidemocratic: overseeing a country's banking system and currency to ensure confidence is a task too

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important and too corruptible to entrust entirely to elected politicians and their short-term appointees.

More than anywhere else in East Asia, economic failure in Indonesia has political roots. From the inception of President Suharto's regime in 1966, Indonesian economists committed to market-based policies managed the economy well and held their own against big-spending nationalists until, periodically, economic success undermined caution and encouraged recklessness. And these times of complacence and overextension were interrupted only by shocks—the near bankrupting of the state oil company in the 1970s, falling prices for Indonesian oil exports in the 1980s, and the economic crisis of 1997-98—that reinstated the technocrats' clout to resume necessary reforms. But the shocks of 1997-98 ran into obstacles, including nepotism, cronyism, and corruption, which blocked the restoration of confidence or growth. More than ever, the president and his family, including his six adult children, are part of the problem.

Nowhere is this more evident than in the composition of the new government Suharto chose in March. His vice president, B. J. Habibie, is a man who spent years as minister of research and technology channeling torrents of public money into unprofitable high-tech projects. As Indonesia's timber king, the new minister of industry and trade was implicated in the profitable restraint of trade in wood products. The new minister of social affairs is Suharto's eldest daughter, who some believe is being groomed to succeed her father. Meanwhile, her brothers have tried to safeguard their business sinecures from reform.

Suharto's ties to relatives and friends help to explain why he has vacillated in the face of IMF pressure to change the economy's opaque ways. He largely failed to implement an initial understanding with the IMF, announced a budget beyond its targets, reinstated costly infrastructure projects, and sought to skirt the strictures of a second, tougher IMF agreement. By February, in the eyes of an increasing number of urban, educated Indonesians, Suharto had become an obstacle to recovery by reform. With political freedom, he might have been rendered accountable, perhaps even replaced, as in Bangkok and Seoul. Without it, Indonesia flounders on.

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FALSE STARTS?

THE ECONOMIES of East Asia are in a race to leave 1997 behind. The leaders—Japan, Taiwan, and Hong Kong—are politically much freer than Indonesia, the laggard. But things are less clear in the middle of the pack.

Nor is it clear that Indonesia will "get the message" and democratize. As so often in the archipelago's past, some Indonesians of non-Chinese descent, especially Muslims, have blamed their pain on the small but economically influential ethnic Chinese minority; in February Chinese-owned shops were looted and burned. But the armed forces continue to block challenges to public order, and the middle class has too much to lose in a revolution to sponsor one. If disorder can be contained, the status quo can probably be maintained, assuming Suharto stays healthy. Even if the economy continues to deteriorate and disorder spreads, repression seems more likely than democratization, at least in the short run.

Question marks hang over other nations as well, including those where democracy has taken hold. In March, opposition politicians in Bangkok were already planning a no-confidence motion against the new government. In Manila the markets worried about the nationalist rhetoric of Joseph Estrada, who was favored to win presidential elections in May. And how long would Kim Dae Jung be able to withstand antireform pressures from business and labor groups? Nor were all authoritarians the same. In contrast to Jakarta's "friends and family" cabinet, Beijing appointed a number of ministers who had risen through the party ranks for their ability to enact reform. Even if liberal democracy does turn out to be their preference, East Asians will not necessarily choose the expensive, divided, and easily deadlocked version of it available in Washington.

In 1998 East Asia is changing—one hopes for the better—but it is not Americanizing. It is important for Americans to think realistically, not wishfully, about the region. It is too early to reinvent the debunked East Asian miracle as a new parable about "Asia rising" toward liberal democracy.

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Japan's Financial Mess

Edward J. Lincoln

IN DENIAL

JAPAN'S ECONOMIC performance in the 1990s continues to be disappointing, frustrating, and worrisome. Tokyo's economic sluggishness in the financial sector is souring life at home and setting off international reverberations. Much of Japan's financial weakness is mirrored in other Asian countries. More important, Japan's failure to deal with its economic woes provides a cautionary tale of the resistance to reform that should be expected elsewhere in the region.

Despite government and media portrayals of imminent "big bang" financial reforms, the reality will be far less dramatic. Among bureaucrats and politicians there remains a strong faith in the Japanese style of capitalism and a resistance to truly liberating financial markets. Nor is the Japanese public clamoring for deregulation. It associates such reform with unemployment and instability in personal lives. Indeed, the Japanese have spent the past half-century trying to reduce such uncertainty.

The problems of the 1990s were started by the bursting of the real estate and stock market bubbles of the 1980s. The government deserves much of the blame for the financial excesses and the stagnation that has followed. Dogmatically conservative attitudes toward macroeconomic policy are delaying recovery. The financial sector is swamped by a mind-boggling array of bad debts and underfunded pension liabilities, amounting to as much as $1.5 trillion. Scandal after scandal exposes unethical or illegal behavior in the financial sector and government. And many of the policies being adopted to clean up

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this mess will delay resolution of the bad debts and counterproductively increase government control over the financial sector.

Despite the torrent of pronouncements from Tokyo about economic stimulus and deregulation, the world will be disappointed with the results. While some financial deregulation will occur, those who believe that Japan will adopt an American economic model are mistaken. Japanese bureaucrats and politicians, including the elite at the Ministry of Finance, continue to be in deep denial. They do not comprehend the extent of reforms necessary to restore the nation to economic health. Instead they regard their current problems as a passing incident with no fundamental implications for the existing system.

These problems harbor a variety of international ramifications. The International Monetary Fund's bailout for Indonesia, Thailand, and South Korea includes substantial reform of their financial systems. Unfortunately, Japan will not be a firm supporter of this initiative. Nor will Japan import many more goods and services as Southeast Asia attempts to export its way out of trouble. Japan has damaged its self-assumed role as a leader of Asia and will prove a weak international partner for the United States.

A CREATURE OF HABIT

JAPAN'S PRESENT economic problems and reluctance to reform itself is a matter of habit: from the late 1940s through the 1970s, the Japanese economy operated with highly regulated financial markets. The financial system intentionally favored intermediation through banks, and banking and securities firms were strictly separated. The government controlled virtually all deposit and lending interest rates, securities trading commissions, and the design and prices of insurance products. Furthermore, foreign exchange was tightly controlled (along with a fixed exchange rate until 1973 and a heavily managed floating rate for the rest of the 1970s) and the variety of financial instruments was subject to approval by the Ministry of Finance. Rather than manipulating interest rates, the central bank kept them below market clearing rates. Commercial banks were therefore dependent on central bank credit to allocate credit to industry.

The Japanese government strongly believed that private markets could not be trusted and therefore kept a firm hand on the economy.

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This approach heavily favored a flow of funds through the banking system while constraining the size and role of bond and stock markets. Banks were more easily controlled and permitted less public disclosure of corporate information than equity markets. In essence, regulation guaranteed high profits for financial institutions, in exchange for which it behooved those institutions to heed guidance and suggestions from the government. This financial system performed well in the high-growth years of the 1950s and 1960s. It is easy to understand the nostalgia that leads the Japanese to want to keep it alive.

BURSTING THE BUBBLE

JAPAN'S ERA of roughly 10 percent annual growth ended in 1973, after which the economy grew at a more modest 4 percent until the early 1990s. The Japanese slowdown has brought a gradual, piecemeal unraveling of the postwar financial sector. Slower economic growth also reduced demand for loans to finance plant and equipment investments by large manufacturers. Eager for new business, large commercial banks moved into real estate lending in the 1980s with the Ministry of Finance's explicit support and guidance. Along with insurance companies and securities firms, they invested aggressively overseas as regulatory restrictions fell. For the first time in decades, the banks were faced with unfamiliar loan clients, but they continued to assume that the Ministry of Finance would guarantee their viability. Their recklessness fed the real estate and stock market speculation of the late 1980s, which caused both urban real estate and stock prices nearly to triple in four years.

Furthermore, Japanese financial institutions' penchant for making investments based on long-term personal or corporate relationships had serious repercussions, especially when banks sought new clients. Banks began financing new borrowers with the same assumption that personal relationships would suffice as a screening mechanism. The herd instincts of Japanese banks took the place of hard-nosed financial analysis.

This explanation, however, puts the most charitable face on what was happening behind the scenes in Japan in the 1980s. The scandals

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that have emerged in the 1990s have revealed shocking examples of indiscretion and malfeasance. Favored investors at securities firms were given guaranteed returns on their equity portfolios. Huge loans went to small businesses for speculation in the stock market and real estate. Large banks eagerly introduced crooked clients to subsidiary banks or credit co-ops in order to keep questionable loans off their own books while hoping to benefit from the business. Financial institutions continued to pay off racketeers who threatened to reveal negative information at annual shareholder meetings. Ministry of Finance officials told banks when inspections would occur in exchange for lavish entertainment and other favors. And there have been allegations that the Ministry of Finance approved and recommended illegal schemes to hide financial problems.

Japan's amount of bad debt resembles that of Indonesia or Thailand.

These scandals go far beyond isolated incidents. They suggest a debilitating fear of disclosing bad news, illegal dealings between financial institutions, politicians, and bureaucrats, and the involvement of organized crime. Presumably much of this behavior took place before, but both the need for new outlets for lending and the euphoria created by the stock and real estate bubbles drastically increased its prevalence.

When the bubbles burst, the fallout included enormous bad debts, the magnitude of which is still not known, mainly because of Japan's loose requirements on reporting nonperforming loans. In late 1997, the Ministry of Finance admitted that problem loans totaled some 79 trillion yen ($630 billion), about 15 percent of all Japanese bank lending and an enormous 16 percent of GDP. These levels of bad debt resemble those in Indonesia or Thailand.

More bad news may be coming since Japanese banks hold roughly one-third of international loans to South Korea, Thailand, and Indonesia. Officially, Japanese lending to Asian countries totals some $125 billion, but it may be larger. An unknown portion of these loans is nonperforming, but if Japanese banks behaved with the same imprudence as elsewhere, the prognosis is not good. Moreover, the banks are already weakened and are not in a good position to absorb additional losses.

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SURVIVAL OF THE WEAKEST

RESTORING JAPAN'S economic growth will be critical to any effort to overcome its financial problems. In a growing economy, new lending causes the share of old nonperforming loans to shrink, reducing the relative cost to financial institutions as they write them off and dispose of the underlying assets. The government's record, however, is not encouraging.

From 1992 through 1995 Japan grew at an average annual rate of only 0.6 percent. In 1996 the economy finally showed signs of recovery, growing at a strong 3.6 percent driven in part by expansionary fiscal policy, including a temporary income tax cut in 1994. But on April 1, 1997, the dogmatic Ministry of Finance chose to end the income tax cut, increase the nation-wide sales tax from 3 percent to 5 percent, and raise other government fees, including copayments in the national health care system. These changes subtracted 2.5 percent from GDP and may have had an additional negative psychological effect on households and businesses. The economy was relatively stagnant again in 1997, and forecasts for 1998 are in the range of one percent or less. Responding to criticism, the government finally devised an income tax cut for fiscal 1997 (payable only in February and March of 1998). But the size of this stimulus was small, and the government followed it with statements that it would contemplate no further tax measures.

Tokyo's reluctance to use fiscal policy to stimulate the economy stems from the fact that the government's balance sheet will deteriorate as Japan's aging population collects its social security. Nevertheless, the government moved too rapidly and too far to balance its budget in the spring of 1997. Restoring economic growth is as important a goal as a long-term reduction of the government's deficit. Domestic financial problems would diminish in a growing economy, and the burden of financing the retirement of a larger percentage of the population would become easier too. Japan's dogged determination to pursue fiscal austerity will hurt the future of the economy by delaying recovery.

Japan's apparent failure to get its economy back on track has not led to a market-oriented approach of letting the weak collapse, forcing investors to take their losses and sell off assets at market prices to get them back into productive use. Only such an approach can address

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the fundamental problems that led to the crisis. In 1997, the Ministry of Finance allowed two large institutions to fail—Yamaichi Securities and Hokkaido Takushoku Bank. But press reports that market rules were now in play and financial institutions would have to sink or swim proved premature. The shutdown of Yamaichi Securities took more than six months, with most of the employees kept on the payroll—financed with loans from the Bank of Japan. During those six months, the Ministry of Finance continued to seek firms to take over all or substantial portions of Yamaichi. (Merrill Lynch, for example, is taking over some Yamaichi local offices and employees.) Similar efforts with Hokkaido Takushoku Bank proved successful: Hokuyo Bank, a regional bank in Hokkaido, agreed in December 1997 to acquire all of Hokkaido Takushoku's operations within the prefecture, and Chuo Bank agreed in February 1998 to acquire all of the bank's operations outside of Hokkaido. This deal was sweetened with promises, since enacted into legislation, that the government would buy preferred shares and absorb bad loans. This is hardly the stuff of a cruel and impartial market. Few people will be left unemployed, and few if any assets will be sent to the auction block.

Japan's dogged determination to pursue fiscal austerity will damage its economic future.

Worse yet, this bailout scheme has now become policy, with the government moving forward in March 1998 with a $100 billion purchase of new issues of preferred shares and subordinated bonds to help recapitalizing banks. Putting government money into bank ownership is a terrible policy. It encourages banks to gamble on high-risk investments to increase their earnings. It also makes the government even less willing to let weak institutions fail because the government's money and reputation will be at risk. Perhaps most important, this infusion will increase Ministry of Finance influence over the whole banking sector since a number of presumably strong banks will issue equity to the government on the excuse of preventing the public from knowing which institutions are weak.

Besides this special new fund, the Japanese government has other means to inject money into the corporate sector without public knowledge. Portions of social security funds, postal savings funds,

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and postal life insurance funds are routed through government subsidiary organizations, which have a mandate to offer portfolio investments in the private sector. These funds can be quietly invested in weak financial institutions or used to help prop up overall stock market prices without the media or public becoming the wiser.

Meanwhile, a variety of other gimmicks appeared in 1998 to improve balance sheets and thereby prevent public recognition of weakness or insolvency. Firms have traditionally listed assets at the price paid for them, which has long injected an element of fantasy into accounting results. Financial institutions will now revalue real estate holdings (mainly the land on which their offices and branches sit) to market value, but they do not have to do the same with stock portfolios, many of which hold shares purchased near the peak of the stock market. Banks will also be able to net out positions with individual customers; rather than showing a single client's loans on the asset side of the books and deposits on the liability side, the asset side will show only the net position. This sleight of hand artificially reduces assets, thereby improving the bank's capital-to-asset ratio. The government has even discussed using public funds to buy real estate to prop up prices.

One can hardly imagine a litany of worse practices to deal with the financial problems in Japan. These policies will prolong the debt problem, artificially support weak financial institutions that are a drag on the economy, and yield a financial sector partially owned by the government. Gimmicks and government capital infusions will probably stave off a serious financial collapse, but at the expense of the economy's long-term health.

JAPAN'S WISH LIST

IN THE MIDST of dealing with its debt problems, Japan is presumably engaged in a sweeping deregulation of financial markets. The agenda for deregulation includes a variety of measures affecting virtually all aspects of finance, to be completed by 2001. The primary changes under consideration include further deregulating foreign exchange, decontrolling brokerage commissions, easing the trading of shares outside the exchange, relaxing rules concerning the over-the-counter market, eliminating the securities transaction tax, legalizing financial

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holding companies, permitting asset-backed securities, easing restrictions on derivatives, deregulating the insurance sector (permitting price competition, allowing greater flexibility in product design, and removing the strict separation of life and non-life insurance companies), lowering the barriers separating banking and securities, and ending the segmentation among different kinds of banks. Deregulation of foreign exchange transactions, removal of the holding company ban, and decontrol of brokerage commissions will all begin in 1998, with other reforms following over the next three years. On the surface, the list of proposed changes is ambitious and would seem to drive Japan toward greater reliance on markets and competition. But will it really happen? There are reasons to be skeptical.

Despite Tokyo's rhetoric, it is willing to let America underwrite Asia's recovery.

First, Tokyo's bailout of the financial sector speaks volumes about the government's true attitude. No matter what the image of the "big bang" reforms, resistance to liberating financial markets persists. Over the past 20 years, the Ministry of Finance has endorsed a gradual deregulation process, but it shows few signs of truly embracing American-style finance. Second, Prime Minister Ryutaro Hashimoto and the Liberal Democratic Party have an overriding interest in restoring their numerical majority in the Diet, for which they seem to believe that the appearance of reform is sufficient. Third, a deregulated financial system requires public disclosure of corporate information as well as controls on insider information. Japanese corporations are infamous for concealing their numbers. Corporate annual reports in Japan convey little useful information, and official financial filings are hardly better. Almost nothing is happening to address this problem, which is woven into the fabric of Japanese society and corporate behavior.

WANTED: A GLOBAL PARTNER

Overall, Japan's situation is not encouraging. An outright financial collapse with many banks going belly-up is unlikely, if only because of the lengths to which the government will go to prevent it. But the more likely scenario—Japan muddling along with substandard growth

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and an unstable financial sector—is hardly more encouraging. Neither scenario is good for Japan, Asia, or the world.

Japan's financial straits do not bode well for the International Monetary Fund, especially as it attempts to reform the financial doings of Indonesia, Thailand, and South Korea. Despite the seriousness of Japan's financial troubles, neither Tokyo nor the public believes in the American economic model. Japan's reluctance to undertake reform implies that its officials will provide only lukewarm support for the IMF and may send conflicting signals to other Asian nations as the crisis moves into its next stage. This is all the more unfortunate since Japan is a leading member of the IMF.

Furthermore, Japan's economic stagnation suggests that it will do little to revive Asia's health. Asia's struggling economies will try to recover by increasing their exports. As the world's second-largest economy, Japan could play a helpful role by absorbing a portion of those exports. But here is the rub: Japan is following the same strategy as its poorer Southeast Asian neighbors. Rather than absorbing more imports, Japan will shift its burden through more exports to the United States. Despite any rhetoric about a global partnership, Tokyo is quite willing to let the United States underwrite the Asian recovery.

The international ramifications of Japan's financial weakness extend beyond economics. The Japanese are now absorbed by domestic problems; they have little interest in the problems of the rest of Asia. Japan was noticeably silent during the recent crisis over Iraq, articulating only the request that any military action be postponed until after the Nagano Winter Olympics. In the midst of South Korea's economic crisis, Japan chose to press a petty dispute over fishing rights. Just a few years ago, Japan was awash in talk of playing a larger role in the world, and the government mounted a modest campaign to become a permanent member of the United Nations Security Council. Today there is little interest expressed in international diplomacy.

The United States must make its dissatisfaction with Japan known. Tokyo's response to the Treasury Department's complaints during the past year gives little reason for optimism. Nevertheless, this pressure should continue. American economic policy should

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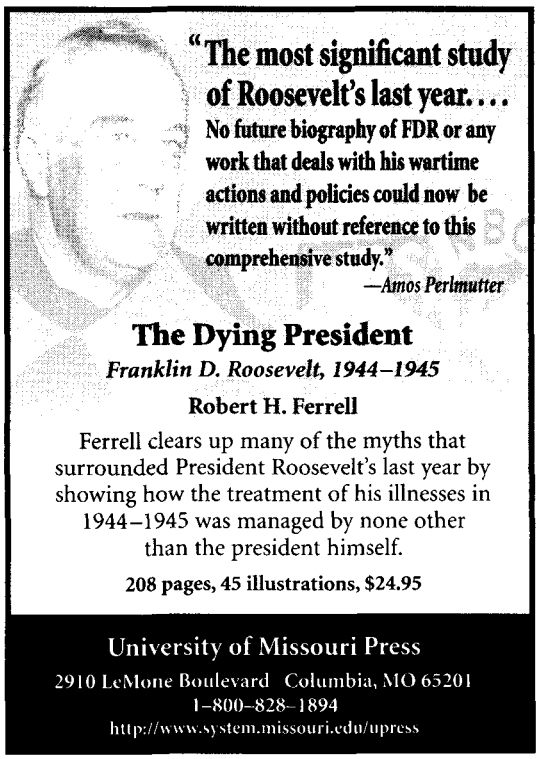
also assume that Japan's economy and financial system will perform poorly for several years to come, implying lower export growth and rising imports for the U.S. economy.

Washington has found it difficult to exert pressure on Tokyo. It is time for the United States to send less-than-subtle signals in other areas of its relationship with Japan. The bilateral relationship includes broad consultative arrangements, within which American officials could simply stop consulting. Through canceled meetings, unreturned telephone calls, and a lack of advance notice of American policy moves, the United States can send the message that it no longer regards Japan as a global partner. This may seem like a heavy-handed way to treat the world's second-largest economy, but under present circumstances it may be the only way to move Japan off a path that is destructive for us all.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Russia's Phony Capitalism

Grigory Yavlinsky

OLIGARCHY OR DEMOCRACY?

RUSSIA FACES a watershed decision. The vital question for Russia is whether it will become a quasi-democratic oligarchy with corporatist, criminal characteristics or take the more difficult, painful road to becoming a normal, Western-style democracy with a market economy. Communism is no longer an option. That was settled in the 1996 presidential election.

Russians will make this fateful choice and be its principal victims or beneficiaries. But its consequences to Americans, Europeans, and others who share this shrinking globe should not be underestimated. Contrary to the widespread view in the United States that Russia is essentially irrelevant or of secondary concern, our continental country, stretching from Eastern Europe to upper Asia, will be important in the next century because of its location between east and west, its possession of weapons of mass destruction, its natural resources, and its potential as a consumer market.

Unlike previous choices in recent Russian history, the decision will not be made on a single day by a coup or an election. Rather, it will evolve through the many decisions made by Russia's millions of people, leaders and ordinary citizens alike, over the coming years. Even President Boris Yeltsin's sacking of much of his cabinet in March, while deeply disturbing, was one more bump along the road, not the end of the journey. Nevertheless, the route chosen will be no less important than the choices made earlier in the decade in its effect on the society in which our children and grandchildren live.

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Corporatist states, marked by high-level criminality but bearing the trappings of democracy, differ more than is sometimes recognized from Western-style market democracies. Their markets are driven by oligarchs whose highest goal is increasing their personal wealth. Freedom of the press and other civil liberties are suppressed. Laws are frequently ignored or suspended and constitutions obeyed only when convenient. Corruption is rife from the streets to the halls of power. Personalities, contacts, and clans count for more than institutions and laws. For examples, one need only reflect on the unhappy experiences of many Latin American countries in the 1970s and 1980s.

Alternatively, in Western-style democracies, markets are driven by the consumer. Government economic policies are intended to serve the nation, not those in power. Through hard work, citizens can succeed. Personal freedom is universally respected, including the right to express opinions that differ from those of the government. Civilian rule is unchallenged. Corruption is normally minimal and its spread swiftly checked. Laws and constitutions are respected by both government leaders and citizens. The contrast with oligarchy is stark. Over the past year, increasing numbers of Russians have come to appreciate that their country stands at a fork in the road.

RUSSIA'S ROBBER BARONS

THE RUSSIAN economy today shows signs of evolution toward Western-style capitalism on the one hand and the consolidation of corporatist, criminal-style capitalism on the other. Western conventional wisdom emphasizes the former and thus sees a Russia moving steadily toward a market economy. Indeed, Russia has managed to lower inflation and, within reasonable limits, stabilize its currency. Moscow is a boomtown. Some of the newly established and privatized corporations that operate with international mentalities and ambitions are making their way to the top. Certain regions of the country have received favorable international credit ratings, and a handful of Russian companies have held successful international bond issues. Young people are now ready to adapt to the new market system and steer clear of crime as the country develops new rules. The International Monetary Fund, while occasionally delaying tranches of its $10 billion

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loan because of poor tax collection, always seems to reinstate them after promises by senior Russian officials to do better. All this seemingly points toward the path of a normalized Western market economy.

But while Russia has its economic success stories, many aspects of the economy suggest that it is moving toward a corporatist market in which corruption is rampant. The most important of these trends is the rise of the Russian oligarchs, who have created a form of robber-baron capitalism. Far from creating an open market, Russia has consolidated a semi-criminal oligarchy that was already largely in place under the old Soviet system. After communism's collapse, it merely changed its appearance, just as a snake sheds its skin.

The new ruling elite is neither democratic nor communist, neither conservative nor liberal—merely rapaciously greedy. In an interview published in the *Financial Times* in November 1996, one Russian tycoon claimed that the country's seven largest bankers, who became the core of Yeltsin's reelection campaign, controlled more than half the Russian economy. No one doubts that these nomenklatura capitalists have had a profound impact on the Russian economy, but their market of insider deals and political connections stands in the way of an open economy that would benefit all Russian citizens. The robber-baron market cannot tackle important social and economic questions. It is primarily concerned with issues that affect its masters' short-term power and prosperity.

At recent debates at Harvard University's U.S.-Russian Investment Symposium and at the Davos World Economic Forum, Western investors sharply criticized the robber-baron mentality of many Russian business leaders and the process of privatization under former Deputy Premier Anatoly Chubais. As George Soros put it, first "the assets of the state were stolen, and then when the state itself became valuable as a source of legitimacy, it too was stolen."

Last summer's auction by the state of the Svyazinvest telecommunications giant is an example of how these tycoons operate. This auction was to be the first where competitive bids were held for a privatizing company. Unlike earlier auctions, where the tycoons collaborated to gain huge shares of industry for a fraction of their actual worth, during the Svyazinvest auction the leaders of the rival industrial syndicates could not agree on who would get the company and were therefore forced

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to bid against each other. The "bankers' war" that ensued was fought not with bullets but through allegations of graft aired by their media outlets. As a result, some of these tycoons were removed from their government posts and corruption charges were leveled against Chubais and his privatization team. Such a fiasco hardly suggests a healthy capitalist system. Worse, as of this writing, the same players are positioning themselves for a second round in the war—the auction of the Rosneft oil company.

There are many reasons why a country with nuclear, chemical, and biological weapons should not be allowed to slip into the chaos of rule by semi-criminal, corporate, oligarchic robber barons. Unfortunately, those who believe that the capitalism of the robber barons will eventually give way to a market economy that benefits all in society, as occurred in the United States at the turn of the century, are mistaken. America had an established middle class with a work ethic and a government that remained largely free of robber-baron infiltration. The American tycoons were still investing in their own country. Russia's robber barons are stifling their homeland's economic growth by stealing from Russia and investing abroad. In the late 1990s, Russia has no emerging middle class, and the oligarchy, which is deeply involved in the government, can alter policy for its private benefit.

Corruption permeates Russia's economy, from street crime to mafia hits to Kremlin graft.

In the meantime, while the big boys—they are all men—fight over an ever larger piece of the Russian economic pie, the government has been unable to create economic conditions in which the majority of Russians can thrive. The problem is not only that the majority of Russians remain worse off than before the economic transition began, but that they cannot become better off. The economy is stagnating at half its 1989 level. Real incomes have fallen by a third, and living standards in most regions have deteriorated to levels not seen in decades. Government attempts to curb inflation resulted not only in tremendous wage and pension arrears, but also in the government's inability to pay its bills for the goods and services it consumed. This led to total disarray in payments, with up to 75 percent of goods and services either paid in kind, or by promissory

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notes that cannot be cashed, or transacted through illegal channels to dodge taxes entirely. In real terms, government pensions and wages were cut to 40 percent or less of their original value, and the government still cannot collect enough taxes to cover these expenses. Tax receipts have fallen to less than 20 percent of the country's GDP. Meanwhile, external debt has skyrocketed, and domestic debt, which was next to nothing just a decade ago, has reached almost 15 percent of GDP. Servicing these debts, paid out to local bankers and foreign speculators at exorbitant interest rates, will take no less than 25 percent of total government expenditure in 1998. The current Russian market economy has created a handful of super-wealthy individuals while leaving the rest behind to struggle. It is no wonder that these economic policies resulted in some 250 communists and 50 ultranationalist Zhirinovskyites being elected to the 450-seat State Duma in 1995.

Furthermore, Russia is bedeviled by a corruption problem reminiscent of Latin America's in the 1970s and 1980s. The European Bank for Reconstruction and Development ranks Russia as the most corrupt major economy in the world. Graft permeates the country, from street crime to mafia hits to illegal book deals in Kremlin corridors to rigged bids for stakes of privatized companies. Recent polls by the Public Opinion Foundation show that Russians believe the best way to get ahead is through contacts and corruption. When asked to select criteria needed to become wealthy in today's Russia, 88 percent picked connections and 76 percent chose dishonesty. Only 39 percent said hard work. Anyone who attempts to start a small business in Russia will encounter extortion demands from the mafia, so there is no incentive for entrepreneurship. Better to stay home and grow potatoes at your dacha. A crime-ridden market cannot be effective. With no certainty about the future, with or without inflation, nobody will invest. Such a market can support the current level of consumption—which for the majority of the population means semi-pauperhood—for some time, but it does not and cannot provide any progress.

With such problems, despite the good news about the Russian economy over the last year, it is clear that the Russian market is still veering toward the corporatist, criminalist, oligarchic path.

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AN UNFINISHED DEMOCRACY

RUSSIA'S CURRENT democratic institutions also deserve a mixed review. Certainly there are reasons for optimism. Russians are freer than at any time in their history. They can now read what they like, travel, talk, worship, and assemble. Russia's citizens have quickly grown accustomed to these liberties. Technological advances such as the Internet, fax machines, and mobile phones will make it impossible for any one source ever to monopolize information in Russia again. Through this continuous contact with the world, with each passing day, Russia becomes a more normalized society.

Perhaps the most often cited examples of successful Russian democracy are the Russian elections. Over the past three years, elections have become an accepted part of Russian life. This was hardly always the case. A mere three years ago, debate raged in Russia as to whether the ruling authorities would even allow elections to occur. But from the December 1995 Duma elections to the June 1996 presidential race to the subsequent gubernatorial and regional legislature elections, again and again elections have been successfully held in the Russian Federation. In many of those contests, notably the Duma election and some regional gubernatorial races, opposition candidates from the communist and other parties have won and taken office. With minor exceptions, voting and ballot counting have been peaceful and relatively free, while voter turnout has been higher than that of the United States.

Although the recent elections are a positive development in the creation of Russian democratic institutions, some disturbing trends point to trouble in the future. While international observers have cited Russian balloting as free and fair, Russian campaigns—most notably the 1996 presidential election—have been notoriously unfair. Spending limits are routinely ignored. While no actual figures have been disclosed, the 1996 Yeltsin presidential campaign is estimated to have cost at least $500 million. Some put it at an even $1 billion. (By comparison, Bill Clinton's primary and general election campaigns that year together cost $113 million.) Officially, Russian presidential campaigns could spend only $2.9 million, but Yeltsin's overspending neither elicited a major outcry nor started judicial proceedings.

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Perhaps even more disturbing is the often cited European Institute on the Media survey that documents the media's flagrant pro-Yeltsin bias. According to the EIM, Yeltsin enjoyed 53 percent of all media coverage, while his closest competitor, Gennady Zyuganov of the Communist Party, received only 18 percent. Yeltsin appeared on television more than all the other candidates combined. Moreover, election coverage was extremely slanted in the president's favor. Giving candidates a point for each positive story and subtracting a point for each negative one, Yeltsin scored +492 before the first round of the election; Zyuganov earned -313. In the second round, Yeltsin had +247 to Zyuganov's -240, despite the fact that Yeltsin disappeared from the public eye a week before the election.

Russia's presidential election in 1996 was notoriously unfair.

Electoral politics, like much else in Russia, are also at a fork in the road. As Russian political consultants learn more tricks of the trade, the danger increases that they might join with the robber barons to try to turn future Russian elections into nothing but window dressing for irremovable oligarchic rule—as was the case in the Soviet Union, where results were predetermined and the people were an afterthought.

Russia's democratic institutions have not developed as fully as its elections. As the recent cabinet firings show, the system of checks and balances is underdeveloped, leaving the country prone to the whims of a mercurial chief executive. The rule of law is often not respected. The judicial branch of government remains overly influenced by the executive branch. The lower house of parliament has made some headway in becoming more than a mere talking chamber in which the occasional fistfight breaks out, and the executive branch now has to lobby the Duma to pass the budget, the START II treaty, and other crucial matters. But Yeltsin and his team still reserve the option of bypassing the Duma altogether—thereby ignoring the constitution—if the Duma disagrees with an executive initiative or is unwilling to be co-opted by promises of some new monthly leadership meeting with the president and prime minister. This strategy is routinely applied to the budget, where compromises are made to ensure passage and are then ignored throughout the year. Another example is the persistent rumor that Yeltsin will seek an unconstitutional third term as president.

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No successful democracy functions without some kind of political party system, but attempts to develop such a system in Russia have been an unambiguous disappointment. Although political factions boasting varying degrees of regional activity exist within the Duma, a true functioning political party system in Russia has yet to develop, for a number of reasons. First, after 70 years of "party rule," Russians are understandably skeptical of political parties. Second, President Yeltsin's actions have actively undermined the development of a political party system. By rejecting any party affiliation, the president acts as if parties and party development are an afterthought in the consolidation of Russian democracy. Yeltsin accepts the assistance of like-minded parties when it is politically convenient and distances himself from them when it is not. So no party is the true party of the government, and Yeltsin cannot be held accountable to the people short of a general election. Third, for political reasons, Yeltsin sought in the past to limit the development of parties by trying to abolish the "party list" system that elects half the Duma, seating only parties that win over five percent of the popular vote. In 1995, only four parties did so, and over half of the Duma seats went to parties opposed to the Yeltsin administration. The list system ensures that parties will exist in some part of Russian society, but in 1998, Yeltsin renewed his call to change it. To better control the Duma, he advocates having the entire chamber elected from regional districts, similar to the system used in the U.S. House of Representatives. With more control over local leaders, Yeltsin believes he can influence who wins these Duma seats. In reality, however, organized crime would buy many of the seats. If Yeltsin succeeds in abolishing the party-list system, he will destroy the only arena in Russian society where parties currently exist without minimizing a major source of opposition. Such a strategy would hurt Yeltsin politically, but even worse, it would damage Russian democracy, which needs a functioning party system to allow people to express their views to the government.

The Russian media also earns a mixed review. On the one hand, Russians have a variety of news sources from which to choose. Opposition newspapers exist, and journalists are free to do investigative reporting and write their own opinions. The November book payment scandal, where senior members of Yeltsin's economic team were revealed to

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have accepted $500,000 for writing a book on privatization, first broke in the Russian media. Political leaders appear on programs like *Hero of the Day* and *Itogi* to explain their views to the people. Even so, in the past two years the media has become entirely controlled by the oligarchs, who are part of the government and use their editorial boards and programmers to promote their own selfish agendas. Nowhere was this more evident than in the Svyazinvest bid last summer, where the resulting "bankers' war" was played out in the media. By reading a certain paper or watching a certain television station, a Russian citizen got either one or another robber baron's version of the truth. Depressingly, the Russian service of Radio Free Europe/Radio Liberty remains Russia's primary supplier of impartial news, just as it was in Soviet times.

In sum, Russian democracy still has a long way to go. True, elections are held, freedoms are respected, parties exist, and the media express divergent views, but such minimum democratic institutions exist in both Latin American and Western democracies. Russia is better off with its imperfect institutions than without them, but they do not yet properly reflect the people's needs and will.

THE WEST'S STAKE

In October 1996, Vladimir Nechai, the director of a nuclear complex near the Ural city of Chelyabinsk, killed himself because he lacked the money to pay his employees and could no longer ensure the safety of his plant's operations. His suicide underscored the most serious threat to all players in the post–Cold War world: loss of control of the Soviet arsenal of nuclear, biological, and chemical weapons. The increasing risks of chaos in a nuclear power are also evident in the rumors of nuclear smuggling. Russia has thousands of tons of nuclear, chemical, and biological material. Under the rule of a corrupt oligarchy, uranium and anthrax could become black market commodities available to the highest bidder. The control of Russia's weapons of mass destruction is an issue of world safety that cannot be ignored by Russia or the West.

Russia and the West face other common challenges. Russia borders some of the most unstable regions in the world. For centuries, it has acted as a buffer between those instabilities and Europe. Today this wall is of no less importance as drug trafficking, terrorism, and arms

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smuggling are becoming rampant. A Russian wall with holes would be dangerous for Europe.

Furthermore, Russia and the West share a desire for stability in order to promote economic development. In recent months, the West has focused on developing the Caspian Sea region's oil resources. Russia is a key player in the area, and finding a peaceful resolution to the Chechen issue will play a large role in determining how oil leaves the region. Moreover, Russia is arguably the greatest untapped economic market in the world. Stability makes possible the development of Russia's economy and presents a great opportunity for Western companies and economies.

A Western-style democracy in Russia would be a partner with the West in confronting the challenges of the 21st century. Russia and the West would work together better to maintain control over weapons of mass destruction and would be more likely to cooperate in containing regional conflict in explosive areas like the Caucasus and Middle East. Finally, the rule of law would govern business relations and allow for economic development and growth beneficial for both societies.

A corporatist Russian government would be more challenging and less stable. Realists may argue that a corporatist Russian government would value stability above all and therefore cooperate with the West to ensure the status quo. But such a system, although stable on the surface, would be built on false foundations, much like today's Indonesia, where any change of leadership could undermine the entire order. Nor would it necessarily be a status quo power. Another scenario has such a government becoming contentious and suspicious of Western actions and goals. Cooperation on important global issues would be less forthcoming, and rules and laws would change to fit personalities, hindering economic development.

Russia's choice will be heavily influenced by the West. Unfortunately, up to this point, the West has not always promoted the correct path. Nowhere is this more evident than in the debate over NATO expansion. If a military alliance moves closer to a country's borders without incorporating that country, it means that the country's foreign policy has dismally failed. Talk that this is a different NATO, a NATO that is no longer a military alliance, is ridiculous. It is like saying that the hulking thing advancing toward your garden is not a tank because

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it is painted pink, carries flowers, and plays cheerful music. It does not matter how you dress it up; a pink tank is still a tank.

The most important message of NATO expansion for Russians, however, is that the political leaders of Western Europe and the United States do not believe that Russia can become a real Western-style democracy within the next decade or so. In their eyes, Russia, because of its history, is a second-class democracy. Perhaps this is understandable. The combination of Chechnya (an arbitrary war in which Russia unnecessarily killed 100,000 people), the collapse of the Russian army, failed economic reforms, a semi-criminal government, and Yeltsin's unpredictability has given the West enough justification to conclude that Russia, for the time being, cannot be a dependable partner and that NATO expansion should therefore continue.

The West's two-faced NATO expansion policy leaves Russians bewildered and bitter.

Ironically, if the United States explained its push for NATO expansion in these terms to the Russian people, they would at least understand why the alliance is expanding and respect the West for its honesty. But when the West says to Russians: "Russian democracy is fine, Russian markets are fine, Russia's relationship with the West is fine, and therefore NATO is expanding to Russia's borders," the logic does not work, leaving the Russian people and their leaders bewildered and bitter. This resentment will only be exacerbated if the West continues its two-faced policy.

Finally, the West's insistence on promoting personalities rather than institutions also hinders Russia from choosing the right path. The West plays favorites, and I recognize that I am one of them, even though I am not in power. The danger comes when the West, while promoting the rhetoric of democracy and capitalism, backs Boris Yeltsin, Anatoly Chubais, Viktor Chernomyrdin, Boris Nemtsov, and Yegor Gaidar even when they embark on actions that do not promote democracy or markets. When Yeltsin ordered tanks to fire at the Russian parliament, the West supported him, as it did—at least publicly—when he ordered the army to start the war in Chechnya. That led most Russians to believe that had Yeltsin canceled the presidential election in 1996, the West would have backed his choice, despite the fact that the decision would have ended Russia's nascent democratic experiment.

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WHAT IS TO BE DONE?

A RUSSIA that works for its citizens and plays a constructive role in world politics will be a Russia that has chosen well. To achieve such an outcome, a new set of rules must be established. The most important step is to separate business from political power in order to fight corruption. There must be a decisive break with the legacy of the past, when administrative power stood above the law. Individual businesses should be regulated by legislation, not by government officials or local barons who are often not easily distinguishable from gang leaders. The power of oil and gas tycoons, who generate huge profits using the country's natural resources, must be curtailed. They should be made accountable to parliament, and their activities should be made transparent and subject to public control.

The present system of economic management, where most large enterprises are run by insiders who disregard the owners' rights, must be radically reformed. "Collective" enterprises, whose management styles and responsibilities smack of the Soviet era, should be eliminated. In their place, the government must encourage responsible management based on a conception of private property that ensures and protects the owner's rights. Bankruptcy laws should be fully enforced to help eliminate incompetent managers, crooks, and Soviet-style directors who are unable to adapt to market realities. Enterprises that hold on to workers and produce nothing but debts should be closed or sold.

Open accounting that meets international standards is a prerequisite to controlling corruption. Also required is a strong, independent, and incorruptible judiciary that will hold crooked officials accountable. For easier oversight, senior government officials should sign a declaration of income, property, and expenses for themselves and their families twice a year for review by the independent judiciary. The law making Duma members immune from prosecution should be immediately repealed. The large number of criminals running for Duma seats to gain immunity is repulsive. How can a legislature fight corruption when its members have their own deals on the side?

Free competition must be promoted by encouraging small and medium-sized businesses and by removing the red tape and excessive regulation that stands in their way. Former Soviet monopolies should

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be destroyed to eliminate domination by a small group of large companies that account for half the country's GDP while employing only three percent of its labor force. Land reform is also essential, since there can be no stable development in the agricultural sector until the major part of the country's land is taken from hands of the oligarchic landlords who "inherited" it from the Soviet state. Finally, both power and financial resources must be decentralized. Russia will be doomed to instability and underdevelopment as long as 85 percent of the nation's money remains concentrated in Moscow. Local initiatives and entrepreneurship should be encouraged if the fruits of economic growth are to be shared among Russia's numerous regional, social, and ethnic groups.

To ensure that an established middle class emerges, an open market economy must appear based on private property and competition. Unregulated prices, low inflation rates, and a stable currency are absolutely necessary. In Russia, however, these are not sufficient conditions for a competitive economy. Lower and simpler taxes, fiscal controls on oligarchs' incomes from the use of natural resources, incentives for entrepreneurship, a trustworthy news service, an independent judiciary, and fully developed political parties are also indispensable.

For its part, the West should hold those in power in Russia accountable for undemocratic deeds, in much the same way as it is willing to criticize its allies. Western leaders should apply to Russia the same criteria for evaluating the health of its democracy and the strength of its market economy that they apply to themselves. The West should not give Russia advice it is not willing to take itself. This is especially important because, in the 21st century, competition will occur between civilizations and not countries. Although Russia and the West have different histories, they belong to the same civilization. The old rivalries need not endure—if Russia chooses wisely.

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India's Problem Is Not Politics

Marshall M. Bouton

MISREADING THE ELECTIONS

INDIA'S RECENT parliamentary elections aroused fears about its political viability, but not about its economy. The fractured verdict—40 parties won at least one seat, and no party won more than a third of the seats—created a hung parliament incapable of ending the political turmoil at India's center. While Sonia Gandhi stemmed the Congress Party's losses by assuming its leadership, the party that once provided India's stability continued its sclerotic decline. At the same time, the strong showing by the Hindu nationalist Bharatiya Janata Party (BJP), which was asked to form the new government, stirred fears that India would abandon its commitment to secularism in public life, setting the stage for sharper Hindu-Muslim conflict, political unrest, and perhaps heightened tension with Pakistan.

Economic issues, in contrast, stirred little alarm. They played practically no role in the elections, despite the current slump in India's economy and the meltdown in East Asia. Instead, most observers assumed that continued economic reforms, even at a slow pace, would keep India moving forward on the higher GDP growth path of six to seven percent attained in recent years.

The reality of India's prospects is just the opposite of these perceptions. The main threat to India's future is not political but economic. India's political system has for several years been in transition from Congress Party dominance to a more splintered picture in which

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regional and caste-based parties control most states, alongside a still unclear political pattern at the center. But neither the kaleidoscope of parties nor frequent changes of government nor the rise of the BJP as the preeminent national party should be mistaken for threats to India's underlying stability or its very unity. Rather, they are integral to the latest stage—a messy one, to be sure—of a social and political transformation made possible by democracy itself.

On the economic front, however, India's reforms are for all intents and purposes stalled, and its relatively poor recent performance—GDP was projected to increase by five percent at most in the 1997-98 fiscal year—is more than a passing business-cycle downturn. The unfinished half of the reforms—structural adjustments needed to lower fiscal deficits, improve financial markets, and create labor market flexibility—are nowhere in sight. During the tedious last two years, observers have consoled themselves over the slow pace with the view that the reform process is irreversible. But elements in the business community have soured on the reforms, no foreseeable government in New Delhi will have the strength to take on those who guard the status quo, and support for structural economic changes remains limited to narrow segments of the population.

A slower pace of reform and lower growth rates will not only cause economic pain but will also endanger India's social and political progress. Indian democracy is mobilizing heretofore sidelined classes and castes seeking both group recognition and material benefits. Regional differences in living standards and growth, a long-standing problem now exacerbated by the reforms, are creating new demands from laggard states. A failure to accelerate reform and growth would make the orderly accommodation of these interests, the reduction of poverty, and, eventually, the maintenance of democratic stability and national unity vastly more difficult.

DEMOCRATIC GLUE

THE WEST pays a great deal of lip service to India's democracy, but democracy is just as often blamed for the country's ills, especially the slow pace of economic progress, government ineffectiveness, social turmoil, and frequent challenges to national authority. More

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recently, the ascent of the BJP has led to fears that democracy could pave the way for an illiberal regime.

This is flatly wrong. India's democratic political system has been the ultimate source of the state's legitimacy, the major avenue of group mobility, and the main ingredient in the glue that has kept the country together. The leaders of India's independence movement are often accused of wrongly choosing democracy in 1947. In fact, they had little choice. Democracy was the only system that could possibly provide political cohesion in a society with little tradition of political centralism, dizzying social diversity, an independence movement built along participatory lines, and limited elections introduced only in the last three decades of British rule.

Only democracy can give cohesion to India's dizzying diversity.

Today a vibrant, durable democracy is well established in India. India has had 12 general elections and many more state-level contests. Despite an electorate of over 600 million—each time an Indian general election is held, it is the largest organized human activity ever—elections have generally been free and fair. Despite illiteracy and daunting logistics, the average turnout in Indian parliamentary elections, including 1998, has been 57 percent of all adults, as compared to an average turnout of 56 percent of only registered voters in U.S. presidential elections since 1948.

Indian support for democracy was revealed in the largest ever national survey of political attitudes and behavior, conducted in 1996 by the Centre for the Study of Developing Societies (CSDS) and *India Today*. Almost 70 percent of respondents said that governance is better because of parties and elections, up from 43 percent in a smaller but comparable 1971 survey. About 60 percent told the pollsters that voting made a difference, a conviction held disproportionately by poor people. Three-quarters dismissed the proposition that only the educated should have the right to vote. The very poor had a voting rate three percent higher than the national average.

Indian voters have repeatedly demonstrated their independence and sophistication. Since 1947, only a quarter of incumbents have been returned to power. Indeed, anti-incumbency was the only common denominator of the 1998 results. For instance, voters in ten states

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voted overwhelmingly against parties they had favored only two years ago. The Indian electorate also learned long ago to split its vote among different parties in elections for both state assemblies and the national parliament.

Governmental instability at the center is in fact partly a result of a healthy extension of democracy's reach. The ballot box has mobilized numerous linguistic, ethnic, and caste groups in the states, leading to the emergence of parties to represent them. Indian voters have been quite decisive in choosing among these and other parties at the state level. In the 1998 elections, for instance, voters in 13 of the 15 major states gave more than half of each state's parliamentary seats to one party or alliance. But because so many regional and caste-based parties are now contesting elections, the aggregation of these choices at the center produces fragmentation.

ACTUALLY, THE CENTER CAN HOLD

AMIDST THE much heightened competition in Indian politics today, the moderation embedded in Indian democracy remains a key source of underlying stability. This tendency is largely the result of the interplay of electoral politics and India's diversity. Because the electorate is so segmented by ethnicity, language, caste, and religion, politicians must build coalitions across parochial lines to gain power, which means in turn that they must avoid appeals that exclude or alienate.

The glue of these coalitions is usually only the desire to wield power or prevent others from acquiring it, which also helps explain India's wobbly governments. Once in office, the disparate coalition partners often have little to hold them together. The 1996-97 United Front government, whose constituent parts were united only by their desire to block the BJP, was easily toppled once Congress withdrew its support. Ironically, this syndrome may also be a problem for the new BJP-led alliance, which showed its fragility almost as soon as the election was over.

But over the longer term, democracy pushes all major political actors, even the BJP, toward moderation and power-sharing. Extremist and separatist appeals almost always wind up being repudiated at the ballot box. India's communists, for instance, moved toward the center and embraced the democratic process soon after independence to stay in the

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political game. In the Punjab, despite a decade of separatist violence and repression, voters strongly endorsed the moderate Sikh party once the political process was permitted to function.

India's diversity also means that few issues can effectively swing a broad geographic or political spectrum of Indian voters. Class-based politics, for instance, have had much less resonance than many expected in a country with such a gulf between rich and poor. Economic grievances are channeled through segmented social groups such as castes, keeping class in the European sense out of Indian politics.

LIMITS OF HINDU NATIONALISM

THE 1998 GAINS by the BJP constitute an important turning point in Indian politics. At a minimum, Congress has been replaced as the dominant party in Delhi for the first time since independence. Some observers also see in the BJP's Hindu nationalist ideology a dramatic and dangerous shift away from the values that have fostered India's "unity within diversity." But there is no need for panic. The BJP will be constrained by the centrist dynamic of Indian politics. The closer the BJP has gotten to power in recent years, the more it has learned that it must moderate or shed its extremist views if it hopes to seize it.

Voters punished the BJP in the 1993 state elections for its involvement in the destruction of the Babri mosque at Ayodhya in December 1992. From then on, the BJP retreated from the more aggressive version of its Hindu chauvinism. Even so, in the 1996 elections it failed to increase its share of the vote or to widen its geographic base. A post-election CSDS-*India Today* survey helped explain the BJP's poor showing: majorities of both Hindus and Muslims agreed that government should protect minorities' interests. So since 1996 the BJP has assiduously softened its Hindu chauvinism, including its promise to build a Hindu temple on the ruins of the Babri mosque. It also developed preelection alliances with regional and caste-based parties in states where it had little chance of gaining support itself.

The BJP's strategy paid off—but more through its alliances than through its own success at the polls. It increased its share of the vote in 1998 by only 5 percent, to 25 percent, and its seat total by only 16. One reason for this modest gain was the surprising and sobering

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losses in two key states where the BJP and its allies ran state governments, Maharashtra and Rajasthan. The BJP's allies accounted for 72 seats, giving it the opportunity to form a government by enlisting support from still more regional parties through still more policy concessions.

The BJP took power, then, with a deeply compromised mandate, dependent on the support of almost 100 MPs from 17 other parties. It has already shelved some of its most controversial plans, such as revoking laws that protect distinctive Muslim marriage, divorce, and property practices. Furthermore, having appealed to voters as the party that could bring stable and effective government, the BJP must act cautiously if it is to both preserve its coalition and deliver on its promise. It is unlikely to antagonize Pakistan by curtailing Kashmir's autonomy or the United States by going openly nuclear.

These constraints are no guarantee that the BJP will pursue a moderate course or be able to hold a government together. There are serious ideological and programmatic differences within the party and between moderate figures like Prime Minister Atal Bihari Vajpayee, and the purist leaders of the Rashtriya Swayamsevak Sangh, the BJP's parent organization, to say nothing of its quarrels with its allies. And if the BJP fails, it will almost surely lose support next election.

ATTACKING CORRUPTION

THE GREATEST immediate threat to India's governance is not tottering coalition governments or the BJP but corruption. The combination of a state-run economy and weak political institutions created all too many opportunities for crooked politicos and bureaucrats. The resultant graft was exacerbated by the concentration of power at the center by Indira Gandhi, the former prime minister. Public trust in government has plummeted. In a recent survey, four of five respondents said the country had become corrupt, and only five percent described either politicians or the police as completely honest.

The problems are deep-seated, but India seems to have turned a corner in its public life. Spurred by public discontent, a process of political reform has begun that promises to reinvigorate both India's governing institutions and its citizens' confidence in them. Progress will be slow, but the country's political and governmental ills are being

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attacked on several fronts at once: electoral reform, corruption, intra-party democracy, and power-sharing between the center and the states.

The attack on corruption has been led by India's judiciary, including a Supreme Court that has rooted out graft at the highest levels. In recent years India's Election Commission, initially led by the maverick civil servant T. N. Seshan, has regulated campaign finance practices and forced political parties to hold more open leadership elections. The corruption issue was probably the most important reason for the Congress Party's electoral debacle in 1996, which sent a powerful message to other parties. Media muckraking has also been vital. For the first time in three decades, there is movement in the right direction.

Another salutary trend is the gradual but inexorable devolution of power from Delhi to state and local authorities. Coalition government at the center has given dramatic clout to regional parties. While state governments may be susceptible to populism and less experienced at policymaking, their increasing importance will bring longer-term benefits: a more open, accountable government and increasingly vigorous political competition at state and local levels, reinforcing both India's democratic process and its economic reforms.

LET'S STAY TOGETHER

THE ABSENCE of a strong party at the center and the growing power of regional parties and state governments have raised fresh doubts about India's ability to remain united. But India's nation-building record is strong. After 50 years, the country's international boundaries have not changed despite several secessionist threats, and the remaining challenges to national integrity are not especially daunting. By comparison, other new multiethnic states, such as Nigeria, Czechoslovakia, and Yugoslavia, have failed, and even older ones like Canada remain at risk.

Several factors explain India's success in forging a multinational state. First, democracy provided a highly effective alternative for disgruntled regions and groups to extremism and violence. Democratic politics let recently mobilized malcontents challenge the Indian state. When a group's demands were effectively accommodated, however, their stake in the political process led them to "buy in." In the mid-1960s, for instance, Delhi drew back from an ill-advised effort to

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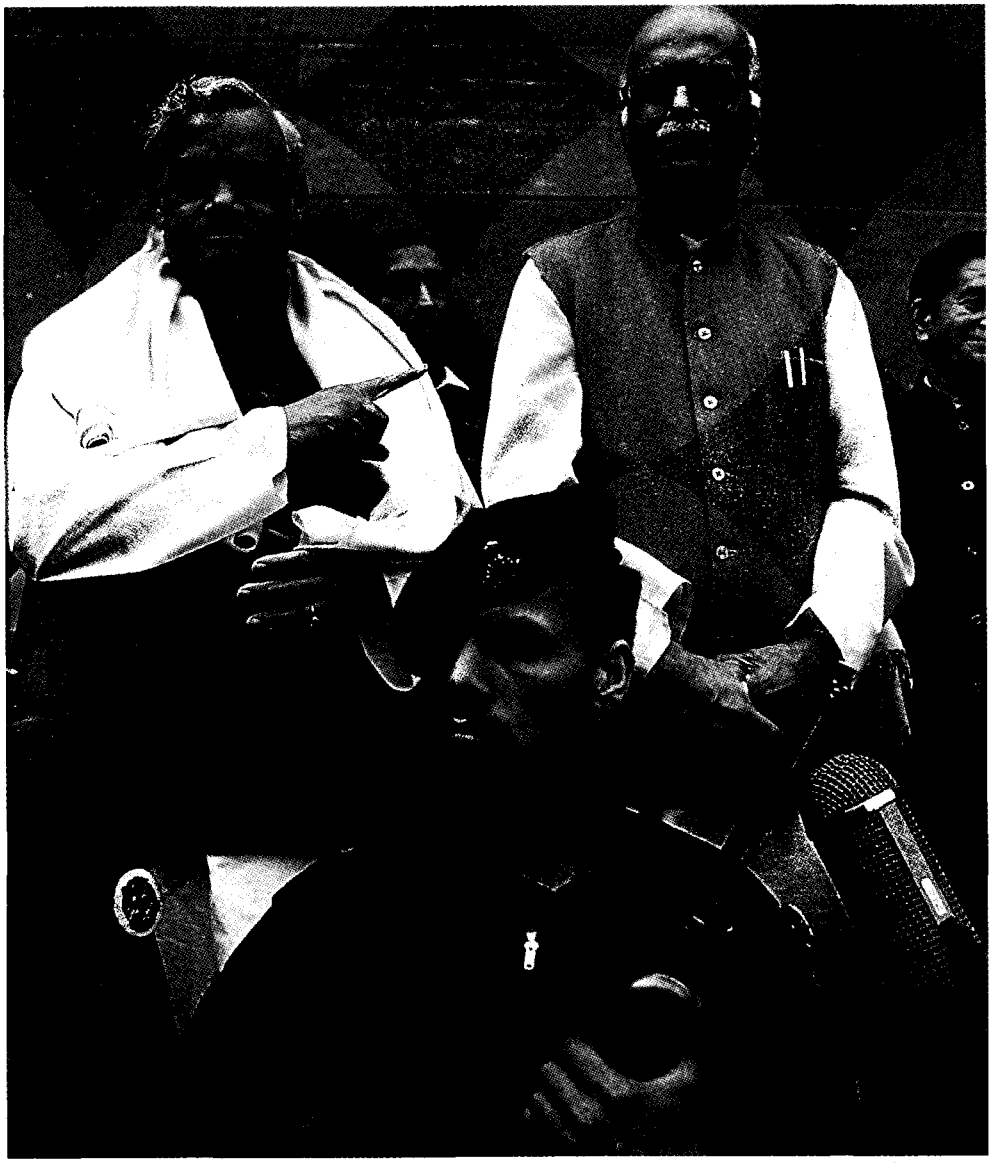

MAGNUM PHOTOS/ RAGHU RAI

Militants no more?: The BJP's Vajpayee and Advani, February 1993

impose Hindi as the official language in the face of fierce resistance from the southern states, especially Tamil Nadu, thereby blunting rising Tamil nationalism. Under the control of regional parties ever since, that state has never had a serious recurrence of separatism, even after India refused to aid ethnic Tamils in neighboring Sri Lanka's civil war.

A second factor is the dynamism of India's federalism. No mere formal division of powers, India's federal system encourages negotiation, compromise, and cooperation. This has been particularly evident in

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the northeast, where Delhi has sought to accommodate demands for autonomy and co-opt ethnic movements amidst rising violence.

The Indian state, on balance, responds well to separatist crises. In the 1960s, Gunnar Myrdal worried that as a "soft state" India would not be able to manage decisively. Certainly there have been mistakes in India's first half-century of nation-building—the festering Kashmir situation is a result, in part, of such misjudgments—but the government's ability to effectively bring its coercive, administrative, and developmental resources to bear has been amply demonstrated in Punjab and the northeast.

TIGER OR ELEPHANT?

ALL THIS is the good news. The bad is that India's economic reforms are at a crossroads. Although long overdue, the reform process initiated in 1991 brought far-reaching change to India's creaky, largely state-controlled economy in just four years. The removal of the "license raj" system that stifled domestic businesses and the reduction of taxes and tariffs, as well as a new openness to foreign investment, generated rapid growth. India's economy, which had lumbered along at 3.5 percent growth per year from 1950 to 1980, picked up to 5.5 percent in the 1980s and averaged 7 percent growth in fiscal years 1995 to 1997. Some claimed that India had joined the ranks of Asia's tiger economies.

Last year, however, India looked more like an elephant again. Industrial growth in the first three quarters of fiscal year 1998 was half that of the same period the previous year and a third of its peak between 1994 and 1996. Agriculture, which had been a star performer in the previous fiscal year, is expected to have negative growth in 1997-98. Exports increased only 4 percent during 1997, compared with an average of 20 percent from 1994 to 1996. One of the few bright spots was the continued influx of foreign direct investment—up 52 percent in the first 11 months of 1997 over the same period in 1996—despite the mixed signals India continues to send foreign investors. In February 1998, Delhi revised its estimate of GDP growth for 1997-98 from 7 to 5 percent, and some economists thought this optimistic.

India's current economic slump has many of the hallmarks of a business-cycle downturn: excess capacity, drooping demand, and weak

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investor and consumer confidence. The rapid growth of 1993-96 generated high levels of investment and capacity, especially by India's previous standards. In late 1995, the government, worried about inflation before the 1996 elections, began squeezing liquidity and curtailing public investment. Retail investors, scared away by the stock market scams and disappointments of the boom, put their spare cash into bank savings and gold instead. Growth slowed, leading to overcapacity in many industries and cuts in business expenses and investment. Delhi's political instability after June 1996 depressed confidence further. Despite the government's lowering of interest rates and other credit relaxation measures in late 1996, the slowdown continued through 1997.

UNFINISHED BUSINESS

INDIA'S BUSINESS-CYCLE downturn is in one sense heartening: the liberalizing reforms of the last seven years have opened the economy to market forces and thus to boom and bust. Alas, India is unlikely to resume the growth of seven to eight percent a year it needs over the long term without further liberalization and structural adjustments. Like Mexico and others, India faces the quandary of a half-completed reform process: the forces unleashed by the first phase of change are driving it toward further reform, but the obstacles and pain of the next phase are greater still.

Even so, further reform is critical for several reasons. First, India's financial sector still cannot effectively mobilize and mediate capital to respond to economic changes. The resulting high cost of capital makes Indian industry and exports less competitive. Although much improved since 1991, India's equity markets are still too thin and volatile to inspire great confidence on the part of domestic or foreign investors. Bond markets are practically nonexistent. Liberalization of the insurance industry, which would greatly improve the investing of India's substantial savings, now 26 percent of GDP, has been stymied. India's banking system remains flawed, with the dominant state-owned banks still carrying bad loans amounting to 15 to 25 percent of their total.

Second, India's abysmal infrastructure is a major constraint on growth. Part of the problem is that financing has been difficult. Ambitious plans

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to improve power generation, telecommunications, ports, and roads have also been thwarted by poor policies, indecision, and corruption. Of eight so-called fast-track power projects initiated in 1992, only two are producing or are close to producing power. Telecommunications reforms were mired first in massive graft and then in battles over regulation; unsurprisingly, many major foreign companies retreated.

Third, Indian trade has been opened enough to expose many companies to greater competition but not enough to provide a strong, sustained impetus for growth. Bankruptcies and near-bankruptcies of noncompetitive Indian companies are on the rise. At the same time, healthy Indian companies that could lower their production costs with cheaper imported goods saw Delhi raise tariffs by three percent in 1997. Export growth might have been a useful counterweight to economic sluggishness at home, but excessive import tariffs, high transaction costs due to bureaucratic inefficiency and corruption, infrastructure bottlenecks, and an appreciating rupee made Indian exports too expensive.

India's growth will be slowed unless it makes painful changes.

Fourth, uncertainty about Indian macroeconomic policy worries investors and managers. Business plans in India have generally been held hostage to unpredictable cycles of inflation caused by government spending, followed by liquidity squeezes to contain it. Delhi has not yet taken the steps that would break the resulting long-term inflation expectations of investors. It reduced the fiscal deficit from a high of almost ten percent of GDP in the early 1990s to about half that by last year. Much of this progress has been achieved, however, by increasing revenues rather than by reducing government expenditures. Subsidies, which primarily benefit middle-class farmers and cost 15 percent of GDP, have generally not been reduced. Support for public-sector enterprises, most of which lose money, has been cut but remains a major drain on government funds. Government salaries were hiked in 1997, a move that may eventually cost as much as five percent of GDP a year without reducing the size of government. As a result, the 1997-98 deficit is likely to be well above five percent of GDP.

Fifth, India needs greater labor market flexibility to make its companies more competitive and its economy more productive. Politically

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powerful labor unions have stifled most efforts at serious reform or privatization of India's largest public sector enterprises, including most banks, all insurance companies, and many major industries—even though privatization would probably cost the jobs of no more than 1.1 percent of the urban labor market. India's labor laws hinder efficiency and growth.

Finally, foreign investment in India, while much increased in recent years, remains far too low. Foreign direct investment approvals have soared since reform began, from 5.3 billion rupees in 1991 to 361 billion in 1996, but the cumulative actual flows have been only one-fifth of the amount approved. In contrast, approved FDI to China has been eight to ten times India's in recent years, and actual flows as a percentage of approvals have been twice India's.

This FDI performance has not even met Delhi's goals—a disappointment born of bureaucratic delays, unclear regulations, and investors' fears of inconstancy from the central government. In the past year, a number of high-profile disputes, including a spat between the Indian government and Suzuki over management of their joint automotive venture, have further diminished investor confidence. And now foreign business leaders will be watching closely to see whether a BJP-led government will keep its promise to implement more restrictive policies on outside investment.

ORPHANED REFORMS

THE REFORM agenda faces growing resistance from both right and left. Powerful Indian industries are now feeling the competitive heat and looking for cover, including anti-takeover legislation, a slowdown of tariff reductions, and aggressive antidumping measures. Both the BJP and Congress have said that they favor protecting Indian businesses for at least five years. Meanwhile, the left will continue to defend fiercely its organized labor base, to which the BJP owes little.

Economic nationalism may be regaining its respectability. The combination of the BJP's ascendancy and the lessons of East Asia's economic crisis has given new currency to Indian protectionism, from delaying capital account convertibility to increasing restrictions on

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foreign investment to slowing tariff reductions. After the election, one BJP leader said India had to liberalize and modernize before it could globalize. A BJP government would no doubt try to be pragmatic on these issues, at least at first; Vajpayee wants foreign investment in some sectors and is loath to renege on India's World Trade Organization commitments. But chauvinist ideology and responsible government are difficult to reconcile.

Political instability and gridlock in Delhi may frustrate restructuring, as they have in Japan. A BJP dependent on more than a dozen parties for its political survival will find it hard to enact even those reforms it favors. Populism remains a staple of state-level politics, and many of the regional and caste-based parties with which the BJP may ally will be wary of policies affecting such key constituencies as civil servants or farmers. Given the current fragmented state of India's national politics, this would be a problem even if Congress and the United Front were to form a government.

So the political base for reform remains narrow. The only significant constituency for reform is the urban middle class, which is at most a quarter of the electorate. By contrast, almost 60 percent of India's electorate is from the rural lower castes, and only a handful of these voters have even heard of the reforms. But the next stage of the reform process, which will create many more losers—notably public sector employees and subsidy recipients—will require a broader base of support than the first stage.

The international environment for reform may be worsening. True, India has been spared the worst of the East Asian troubles because of its lower dependence on exports, healthier current account balance, modest short-term debt, and the limited convertibility of the rupee. But the danger has not yet passed. Currency depreciations in East Asia are forcing the prices of tradable goods down, further threatening Indian producers and fanning protectionist sentiment. If the new government reverses course and lets the rupee depreciate, it will have to deal with higher inflation, especially if it also chooses to prime the pump with increased government spending. Direct investment from East Asia will suffer, and more cautious portfolio investors may shy away from India.

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REMEMBER THE POOR

OVERCOMING THE obstacles to further economic reform will be a long and challenging process. Few observers in 1991 would have predicted that India would come as far as it has. But until now, Indian leaders have generally followed a "reform by stealth" strategy to avoid arousing opposition. This is neither desirable nor possible in the next phase. To build support for restructuring, Indian leaders will need to broaden the reforms and sell them to India's people.

The reforms must be seen to benefit India's huge rural, lower-caste population. Without their support, agricultural subsidies cannot be reduced or eventually eliminated. In the end, the most important constituency for the reforms is the rural poor, whose increasing political participation and rising economic expectations must be accommodated to maintain political stability.

The next phase of reform must therefore give greater attention to improving agriculture, which grew at an annual average of only 3.6 percent from 1991 to 1997 despite a series of favorable monsoon seasons. Higher growth and incomes can be attained relatively simply by deregulation and by investing in rural infrastructure. Social spending must also increase. Improvements in health, education, the water supply, and sanitation will have both immediate and long-term payoffs. While public investment here has been growing, it could increase dramatically if other government expenditures were brought under control. Finally, widening economic disparities between India's regions and states, particularly the fast-growing west and south and the slow-growing east and north, could become a ticking time bomb. Market-friendly measures to narrow these gaps without cutting off growth could pay major dividends in support for reform.

As India approaches the close of its 50th year of independence, it has, by any reasonable standard, done quite well at nation-building. The two most important objectives of Gandhi and Nehru in August 1947—political viability and national integrity—have been met. The recent political and economic reforms will, if successful, strengthen the Indian body politic and improve the living standards of close to a billion citizens. Achieving these goals will require a degree of vision and courage from today's leaders even greater than that of India's founders.

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The Trouble with France

Dominique Moïsi

A ROTTEN MOOD

To Americans, France is a beautiful country, home to that most elegant of cities, Paris, the seductive tones of the French language, and some of the world's finest wines, which makes it all the more difficult for them to understand how such a charming nation could be so irritating an ally. The French always seem to be opposing the United States on some issue or other, whether it is in the realm of international diplomacy, where between the lines of France's carefully worded diplomatic statements one can discern a distinct distaste for America's oft-proclaimed sole-superpower status, or on matters of culture, where France is always the first to denounce American "cultural imperialism." Lately, Franco-American friction has manifested itself most visibly in the Persian Gulf, where France's interests—in Iraq and Iran—seem to clash with America's security needs. Many Americans ascribe France's prickliness to the legacy of "Gaullism," the conservative, nationalist inheritance bequeathed by that country's greatest twentieth-century leader. But in France nobody even knows what Gaullism means anymore, apart from being able to say no to the United States.

In fact, the annoying behavior coming out of Paris is best explained by the fact that the country is, quite simply, in a bad mood, unsure of its place and status in a new world. The less confident France is, the more difficult it is to deal with. On the eve of the 21st century, France faces four major challenges, which are together the source of its melancholy. The first is globalization, which is often blamed for the erosion of France's culture and its depressingly high levels of unem-

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ployment. (Last year, one of Paris' biggest bestsellers was a tract titled *The Economic Horror*—a bitter philippic against globalization's ills.) The second is the unipolar nature of the international system, in which the United States leads and a once-proud France is grudgingly forced to follow. The third is the merger of Europe, which threatens to drown out France's voice. The fourth, and by far the toughest, challenge is France itself. The nation must overcome its economic, social, political, moral, and cultural shortcomings if it is to successfully face its other challenges. The rise of Jean-Marie LePen's extreme right National

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Front is symptomatic of France's internal difficulties. To combat them, France must, in essence, transcend itself.

IT'S NOT EASY BEING MEDIUM

ALL MEN ARE equal, but some are more equal than others. In the age of globalization, size matters. If small is beautiful and big is powerful, then medium is problematic. The Internet, information technology, and other trappings of the global economy can reinforce the centrality of the United States or multiply the strength of a small city-state like Singapore, but they often penalize middle-size countries like France. France's special strengths are its culture and its heritage, and these are being worn away, replaced by a "universal culture" that looks strangely American. If France were a young state, less set in its ways, less burdened by the weight of old traditions or images from the past, it might be able to adapt. But France is an ancient country. It cannot forget its history, and in trying to reconcile it with elements of the modern world ends up merely superimposing it upon them, creating a hodgepodge that is true to neither. Tellingly, France's most popular computer game today is not a high-tech, outer space adventure, but a thriller called "Versailles," which takes place amid the grandeur of the court of Louis XIV.

Consider the difference between France and the United States. America is not only big and young; it is, above all, open. French society remains closed and rigid—incapable of attracting the best talent from other countries while unwittingly supplying its own to America. For example, Dr. Luc Montagnier, codiscoverer of the AIDS virus, now teaches and conducts research in the United States because he reached mandatory retirement age at the Institut Pasteur. Contrast the essential message of Hollywood—if you want to make a difference you can—with the classical archetype of the French movie: A loves B, who loves C, who loves D, all of whom end up in despair. America's flexibility can be seen in the success of its melting pot, which, in an age of globalization, is exported worldwide. Today, the sounds of the world are essentially African-American, everybody eats Italian-American pizza at least once a week, and children the world

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over delight in films by an Eastern European, Jewish American named Steven Spielberg. The American-accented brand of English is the closest thing we have to a universal language, while the French, obsessed with defending "Francophonie" and dreaming of a world united by their tongue, erect protective linguistic barriers, not understanding that this isolates them instead of preserving their culture. What France should seek to preserve—once it has conceded defeat in the language battle—is the context and originality of its message, not its medium.

France's struggle with globalization is complicated by its people's high quality of life. Most of the French feel they have little to gain and much to lose from globalization—the space and beautiful diversity of their countryside, the quality of their food and wine, and the respect for tradition. Why risk all these unique pleasures for the sake of an uncertain competition in a global world? The temptation for many Frenchmen is to retreat into the protective bubble of the good life.

TOPPLING THE GIANT

THE END OF the Cold War only reinforced French envy of America. They resent the global reach of America's power and Washington's presumption to speak in the name of the international community. Unlike the pragmatic British or the historically guilt-ridden Germans, the French feel that they, like the United States, carry a universal message. Remember that France, like the United States, is the font of ideas about "the rights of man," liberty, equality, and fraternity. French frustrations are exacerbated by the mixture of benign neglect, sheer indifference, and mild irritation with which Washington considers Paris' initiatives. In the absence of the unifying threat posed by the Soviet Union, Franco-American tensions can be eased only by shared interests. In the short run, France's jealousy of America will be muted by the political constraints imposed on it by a united Europe, the other members of which do not share France's feelings. The French know all too well that their secret dream—to build a Europe that will challenge the United States—is the nightmare of their continental partners. By

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openly expressing its differences with America, over the Middle East for example, Paris more often than not isolates itself from London and Bonn, not to mention the rest of the European Union. There are, however, subtle issues on which France can tilt Europe against America. If France is alone in supporting Iraq, for example, on Iran the rest of Europe is on its side and against the United States.

France's dream of challenging the United States is the rest of Europe's nightmare.

On security matters, Paris and Washington are at once allies and competitors. France's ambition to create a genuine European foreign and security policy, although formally welcomed by Washington, clashes with the United States' inclination to take the lead. France well knows that its long-term European ambitions will require it to rejoin NATO and give up on trying to attain some special status. France understands that more Europe tomorrow means more NATO today—a bitter pill, since expanding the alliance could reinforce the U.S. monopoly on security. But there is no alternative, since Europe lacks the political will to take on such a large commitment alone. In fact, the French have come to see any expansion of NATO without a corresponding widening of the European Union as an American attempt to preclude any specifically European initiatives in the security field.

In Paris, the peaceful end to the most recent crisis in the Persian Gulf was considered a triumph of French diplomacy over American belligerence. But it was a cosmetic victory, since Saddam Hussein's receptiveness to diplomacy was certainly the result of his fear of being bombed by America. The neat division of labor that France and the United States enjoyed in the Middle East in the 1970s—France in Baghdad, America in Tehran—did not exist this time around. U.S. and French policies over Iraq are antithetical—the French eschew military options, and the Americans show little faith in diplomacy. This essential difference will not disappear and could rebound at the first opportunity—most probably when Saddam takes his next adventure.

Exploiting its position as a permanent member of the U.N. Security Council, France can present itself as an alternative Western voice

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to the nations of the Third World. In the Middle East, for example, Benjamin Netanyahu's election and the resulting stall in the peace process has given a new legitimacy to Europe's and in particular France's role as an honest broker between Arabs and Israelis. Not content with merely bankrolling a peace process led by others, France intends to play a more active role, political as well as economic, complementing the United States but not replacing it. But the French cannot afford to balance America's pro-Israeli position simply by being pro-Arab. France must demonstrate that it is serious about peace. It has certain advantages: unlike the United States, it is not a prisoner of domestic politics. If Paris cannot make peace, it can at least facilitate it.

On the African continent, the French must admit that they need Washington's clout, just as Washington must admit that it needs France's experience and presence. Africa brings out the best and the worst in the French. France is per capita the largest donor of foreign aid in the world after Japan, and well ahead of most European countries. But French money has gone more to regimes and leaders than to the African people. Rivals in economic terms, Paris and Washington are necessary geopolitical partners in this area. The United States has been keen to reassure the French that America has no secret agenda, no ambition to become Africa's gendarme. In fact, the French are starting to realize that their views on the continent's future converge with those of the Americans. Both fear regional destabilization, as in the new Democratic Republic of the Congo, formerly Zaire.

LOST IN THE CROWD

ALTHOUGH "EUROPE" does not yet exist in security and diplomatic terms, it is very real in economic and commercial terms, an actor whose power and influence will be strengthened by the coming of the euro. This is the only hope for the Europeans to balance America—only in the monetary field does a new bipolarity seem within reach. There is an irony here: The only card with which France can challenge American hegemony is Europe, and to play it, Paris must abandon much of its sovereignty.

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For the Germans, European unification has been, together with their participation in NATO, the way to sever their links with their Nazi past, to erase the grim legacy of that dark period. For the Italians, always in search of domestic stability and a way to overcome their low self-esteem, Europe provides legitimacy, allowing them to triumph over their doubts about themselves and the credibility of their nation-state. For France, however, Europe—in its various forms, from the confederal model favored by de Gaulle to the federal one preferred by François Mitterrand—has been at the very heart of the French nationalist project, a way to pursue France's past glory and power by multiplying its influence. For France to remain France, it must become Europe. Leaders of the left and the right, once in power, have strictly adhered to the European credo. France's allegiance to the cause of Europe is now focused on the achievement of a common currency. To create a common European identity, to strengthen the voice of Europe in the world, to forge a new economic power, there is only one answer: the euro.

A united Europe will allow France to multiply its influence.

Yet for all of France's devotion to the European ideal, one can sense its apprehensions. Beyond their fear of having created a technocratic monster, too intrusive for some, too impotent for others, the French worry about their country's place within this new and enlarged Europe. In 1992, the debate about the Maastricht referendum was really a debate about Germany. Did the treaty offer the best guarantee against the potential threat of a reunited and powerful Germany, or would it lead to German supremacy in Europe? Does France run the danger of being squeezed between an economically dynamic Britain and an ever more powerful Germany? The city of London has recovered its old financial power, bursting with energy and activity. Berlin, once torn, will soon become not just the capital of the new Germany, but the capital of the new Europe. But Paris, some French fear, is in danger of becoming a new Rome, a pleasant and beautiful metropolis but one that is mainly a museum of its own past.

For now it seems that France's best option is to continue to pay lip service to a united Europe and promote the euro, while taking

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advantage of the lack of a diplomatic and military "Europe" to pursue an independent French foreign policy. This is the kind of Janus-faced exercise for which France certainly has the cunning and skill but which could prove dangerous for the future of Europe—if France were to be imitated by the Germans, for example.

Hesitant about their influence within an enlarged Europe, with a strong Germany at its center, the French are also anxious about the applicability of France's model of state centralization to the requirements of a new Europe. There is a nagging fear in France that Britain's laissez-faire economic model, built by Margaret Thatcher and largely preserved by Tony Blair's New Labour, and Germany's form of decentralized government are more modern than France's old-fashioned statist recipe—a fear bolstered by the number of young French who are heading to Britain to find jobs in that dynamic economy. The state, once the pride of France, is now the main obstacle to adjustment and change.

L'ÉTAT, C'EST LA FRANCE

THE FRENCH behave toward their state the same way that adolescents behave toward their parents: with a mixture of rebellion and submission. They criticize its heavy-handedness and inefficiency, but they appreciate its reassuring presence and protection. The spring 1997 legislative elections, which brought the Socialists to power, perfectly demonstrated this contradictory attitude. Socialist leader Lionel Jospin's triumph showed that, on a moral and political level, the majority of the French want a less corrupt and more accountable government. At the same time, the electorate wants the state to protect the weakest, poorest elements of society and regulate the effects of the market. For example, Jospin's plan to cut the maximum working week from 39 to 35 hours, against the wishes of many employers, may not make sense economically but is in tune with the feelings of most Frenchmen, who want to be protected by the state from long working hours. It does not matter to them if the idea that governments can create jobs better than market forces is outdated. France is a conservative society—its majority clings to the status quo.

The centrality of the French state is compounded by the society's rigidity. France's work force, for example, is decidedly less mobile

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than Britain's. Too many people prefer to remain unemployed instead of moving to new towns or villages to fill jobs. This may contribute to family stability or the harmony of social life—which means that French families can always have Sunday lunch at grandma's—but certainly not to the dynamism of the economy.

Criticisms of the state extend to those who incarnate it at the highest levels. The prestigious but stiflingly conformist civil service training school, the National School of Administration, is the focus of most complaints about the administration and political class, since its graduates have long monopolized the corridors of power. The French often accuse their civil servants of knowing neither the importance of social dialogue nor the way to govern in a genuinely democratic environment in which all citizens expect to be treated as equals. These attacks are almost reminiscent of their ancestors' challenge to the nobility at the end of the ancien régime. If those who embody the state at the highest level cannot find an answer to unemployment and social injustice, the French ask, why should these mandarins enjoy virtual immunity from accountability?

Since the days of Alexis de Tocqueville, France has been described as a country forced into revolution by its inability to reform. Although today's France is not about to revolt, it is suffering from a lack of hope for the future, which in large part explains the success of rightist groups like the National Front. The French economy is actually doing far better than the unemployment figures suggest: French industry is increasingly competitive, the trade balance is positive, inflation is down, and the franc is strong. Nevertheless, the French are morose. Their country is slowly and painfully transforming itself from a welfare state into a modern one, learning to live within its means. France has not chosen the easiest path to its goals and certainly not the most direct one.

IN SEARCH OF IDENTITY

EUROPE'S ATTEMPT to transcend its fratricidal quarrels by integrating its resources, economies, currencies, and political institutions into a quasi-federal state will serve it well in the global era. Regionalization is the best way to meet the challenges of globalization, because it makes

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states bigger, and bigger is better. But globalization reinforces the likelihood of fragmentation. Today, the need to express one's difference in a global world leads to a desperate search for identity that can end in peaceful divorce between some nation-states and jingoistic tensions and bloody conflicts between others.

France is a country forced into revolution by its inability to reform.

France is a perfect example of this identity dilemma. For decades the French have oscillated between celebrating their exceptionalism and proclaiming its end. Today France is torn more than ever between the desire to be a modern, normal country and the reflex to cling to the belief that France is not like other nations. The first choice presupposes openness, flexibility, and a secure sense of one's identity. The second opposes globalization, is wary of a more unified Europe, and embraces anti-Americanism. But the second choice is no choice at all; protectionism would lead to isolation and decay.

France is probably sicker politically than is generally thought. The fact that large numbers of the French have thrown their support behind LePen's National Front, which is highly represented in the country's regional assemblies, indicates that the people of France have reached the end of their tether. Gripped by despair over their country's high unemployment rate and declining importance in the world, they have begun to cast their lot with the exceptionalists, in a wistful but dangerous attempt to recapture France's past glory. The moderate right is falling by the wayside, incapable of producing a message that will resonate with the masses like LePen's and increasingly co-opted by it. The left and the Socialists, though in power, must contend with the fragility of their own coalitions. Corruption—and the threat that it will be exposed—hangs like the sword of Damocles over the heads of politicians on both sides. All of this combines to coarsen France's political life and plunge the country further into its depression.

Yet despite the weaknesses, there is hope for France. The exceptionalists may be making gains, but for the time being, they are in the minority. Indeed, the National Front has lost its only seat in Parliament. And the more successfully France's internal problems, particularly its

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unemployment, are tackled, the less political and social discontent men like LePen will have to exploit.

France has surmounted crises worse than this current crisis of confidence. Its long history will ultimately guarantee its stability. The land of Liberté, Egalité, Fraternité will not soon cede all of that for an imaginary kingdom of French supremacy, for its citizens know the despair that would bring. The French will come to realize that globalization, that most feared bogeyman on the streets of Paris, will not bring France's demise but rather force it to hone its skills and refurbish its message. A more unified Europe will not smother it but in fact give it new purpose, allowing it to determine its own destiny in the world far better than it could do alone. The depression will subside. In the end, France will endure.

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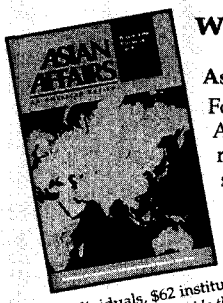

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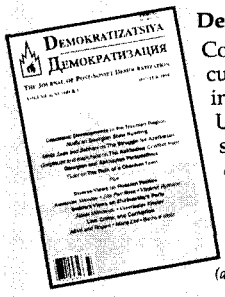

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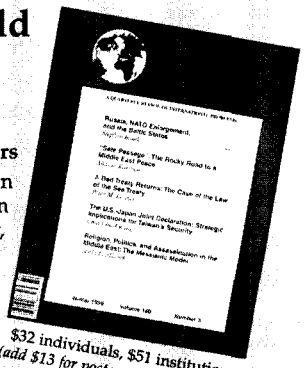

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Reviews

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Richard Holbrooke and Slobodan Milošević in Dayton, Ohio, November 1, 1995

Holbrooke's team leashed the junkyard dogs late in the day—too late for Bosnia.

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Review Essay

After the Vultures

Holbrooke's Bosnia Peace Came Too Late

Roger Cohen

To End a War: From Sarajevo to Dayton—and Beyond. BY RICHARD HOLBROOKE. New York: Random House, 1998, 432 pp. $25.00.

In May 1995, after more than three years of bloodshed in Bosnia, Richard Holbrooke finally lost it. An ineffectual flurry of NATO bombing against Bosnian Serb positions had led to the Serb seizure of more than 300 U.N. peacekeepers and predictable diplomatic paralysis. Holbrooke's recommendation to the White House was blunt: bombard Bosnian Serb leader Radovan Karadžić's self-styled capital in Pale if his men did not release their hostages within 48 hours. The suggestion—made from Budapest, where Holbrooke was about to wed the writer Kati Marton—was met with incredulity in Washington. But as Holbrooke, the Clinton administration's Bosnia envoy, relates in *To End a War,* he was not joking. "I'm serious," Holbrooke told the State Department, "but now I have to get married."

The incident—at once grotesque, tragic, and faintly comical—says much about the former assistant secretary of state for Europe, whose rage for peace helped bring an end to the war, and about the cautious administration he served. It also touches on this memoir's fundamental but generally understated tension: between Holbrooke's espousal of forceful solutions and the hesitations of an American military establishment haunted by "mission creep."

Holbrooke has Bosnia in his blood. Early visits in 1992 to Banja Luka and Sarajevo ensured that the genocidal Serb rampage against the Muslims that year—the central event of the war—was no abstraction to him. Unlike the mealy-mouthed majority, he had a memory. So

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armed, he understood that negotiation was useless without the credible threat of force. The West, he warned, "could not expect the Serbs to be conciliatory at the negotiating table as long as they had experienced nothing but success on the battlefield." Moreover, Holbrooke was comfortable with the sort of improvised theatrics that sometimes makes *To End a War* a study in Balkan diplomacy as the art of the burlesque. In many respects, Holbrooke's achievement was peace-by-tantrum, and in every respect, he was an unusual figure in Bill Clinton's Washington.

By now, Holbrooke is a familiar personality. His bulldozing bluntness, voracious appetites, demanding ego, infectious warmth, impatience with mediocrity, patriotic belief in American power, and oddly guileless sensitivity have been much pored over. The attraction is mutual; Holbrooke's obsession with the press is overwhelming. (Full disclosure: I am described as "one of the most knowledgeable journalists to cover the war.") A lot of compliments are handed out—the late Pamela Harriman is "remarkable," the former ambassador to London, Admiral William Crowe, is "powerful," and, most bizarrely, Dayton, Ohio, is "charming."

But it is a deeply serious Holbrooke who stands at the heart of *To End a War.* This is the story of the struggle of a dedicated public servant driven by an almost frenzied passion to wrest from the wreckage of Bosnia a peace worthy of America's name and values, and thereby shore up the deeply divided NATO on which America's future in Europe depended. His appointment as peace emissary came only after a Western failure so protracted, so shot through with hypocrisy, that Bosnia's mottled, multiethnic fabric, NATO's unity, and the optimism of the Cold War's end had already been shredded. To the last, Holbrooke had to deal with officials for whom "quagmires," "body bags," and other specters of Vietnam and Somalia were far more real and relevant than what, by 1995, was the ritual agony of Bosnia.

From these inauspicious elements, the Dayton peace agreement of November 1995 emerged. Concluded after 21 days of pizza-littered talks at an unlovely Air Force base in Ohio, the accord was imperfect, as Holbrooke himself concedes here. At once an ambitious blueprint for a single Bosnian state and a desperate compromise containing the lineaments of a potential partition, Dayton stopped the fighting but has thus far failed to lay a lasting foundation for peace that would allow American troops to come home. Thus the agreement's place in history, and by extension Holbrooke's, hangs in the balance. This book has the impassioned, sometimes indignant tone of a man still fighting a battle.

Despite its title, *To End a War* is no how-to manual. Holbrooke throws in several reflections on the peacemaker's craft—"negotiating requires flexibility on tactics but a constant vision of the ultimate goal"—and is at his hard-nosed best designing negotiating tables small enough to ensure that the unwanted (especially lowly Bosnian Serb functionaries and pouty Europeans) have no place at them. He also offers some telling thoughts on Balkan diplomacy as a particular art form: "The best way to confuse someone in the Balkans, we often said, was to accept his initial proposal without change, at which point he would change his own position!" This observation was particularly true of

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Alija Izetbegović, Bosnia's president, who drove Holbrooke to distraction at Dayton. But Holbrooke—a man of action and instinct, a man once appalled by Robert S. McNamara's suppression of the emotional—is little inclined to offer pat conflict-resolution formulas. As he writes, "We're inventing peace as we go." The going is rambunctious and fascinating. Holbrooke provides a roller-coaster ride, from the driver's seat, through the decisive months when the United States was reluctantly compelled to reassert its leadership in a wounded Europe.

FOOLS HANG BACK

The Bush administration had been inclined to leave the Yugoslav mess to the Europeans. Once in office, Bill Clinton made a mockery of his bold words on the stump in 1992 ("the high cost of remaining silent and paralyzed in the face of genocide") and stumbled through three years of blabber about intractable thousand-year-old Balkan rivalries. When the United States at last took the lead in Bosnia, the reason was not some abruptly discovered moral or strategic imperative. It was failure, repeated and devastating failure—combined with the bleak prospect of fulfilling Clinton's promise to send American troops to extract the U.N. peacekeeping force—that finally put the administration's back against the wall.

In the grim summer of 1995, the renewed Bosnian Serb bombardment of Sarajevo, the Serb capture of the Srebrenica "safe area," the Serb massacre of several thousand Srebrenica Muslims, and the lightning Croat victory over the Serbs in the Krajina revealed the utter vacuity of the West's Bosnian commitments and changed the strategic equation. Even for the cynical "this-is-the-Balkans-you-know" school of Western officials, Srebrenica was one humiliation too many. For a jittery Pentagon, the unexpected Croat triumph in the Krajina was a decisive indication that Yugoslav President Slobodan Milošević and his army were not about to defend the Bosnian and Croatian Serbs they had armed, financed, and incited just four years earlier. A narrow diplomatic breach was thus opened through ethnic cleansing, cold-blooded killing, and ignominy.

Enter Holbrooke, quietly fuming. He has been sidelined as his erstwhile friend, National Security Adviser Anthony Lake, has drafted a seven-point plan for peace that, to Holbrooke's dismay, called on the Bosnian government to give up its one remaining eastern enclave, Goražde. After Srebrenica, Goražde cannot be abandoned, Holbrooke insists. Lake is won over. But the simmering rivalry between the two men—and between the State Department and the National Security Council—persists; indeed it amounts to an underlying theme in the book. Holbrooke, now a banker, clearly remains a public-servant-in-waiting, and he is not inclined to fire broadsides at administration officials, past or present. At times the book is irksomely arch in its restraint; Holbrooke seems to be hedging his bets. But his irritation with Lake is clear enough. When Holbrooke's peace shuttle—cut unusual slack by the State Department—gets moving, Lake wants to create an NSC committee to oversee it. When a Muslim-Croat offensive gathers momentum in September 1995, helped by NATO bombing, Lake presses for a cease-fire while Holbrooke would rather win on the battlefield land that will be "hard to gain at the peace talks." When discussion

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turns to what American forces will do in Bosnia if peace is made, Lake argues "against a 'nation-building' role for the military" and worries "about the 'slippery slope' in Bosnia."

In the light of advice like this, President Clinton's craven retreat from his campaign-trail promises becomes more readily understandable; so does the circumscribed approach to NATO's mission that has characterized most of its actions in Bosnia since Dayton. This policy, to Holbrooke's evident exasperation, has left free Karadžić and his longtime military commander, Ratko Mladić, despite their indictments by the U.N. war crimes tribunal in The Hague. Yet as the chief architect of the peace writes here, "Karadžić and Mladić will have to be captured. This is not simply a question of justice but also of peace. If they are not captured, no peace agreement we create in Dayton can succeed."

Of course, Lake's caution is also the Pentagon's. Some of the most fascinating passages in *To End a War* center on the confrontation between Holbrooke's "maximalist" view of what American forces can achieve and the "minimalist" approach of their commanders. Holbrooke was in Vietnam as a young Foreign Service officer but has deep reservations about that war's legacy in the Pentagon: an obsession with mission security and the avoidance of casualties that led some top military brass to suggest 500,000 soldiers would be needed in Bosnia; a fixation on an "exit strategy" that led to the first, unrealistic 12-month deadline for the Bosnia deployment; and an all-consuming concern with avoiding a fuzzy mission that has led American forces to eschew not only the arrest of war criminals, but also a more active role in establishing the freedom of movement and security necessary for more than two million refugees to return to their homes. The result is that no Americans have been killed in hostilities in Bosnia, but the idea of a united country still lies largely moribund.

With Admiral Leighton Smith, the first commander of NATO forces in Bosnia, Holbrooke's anger spills over. He is outraged that Smith stood by in March 1996 and allowed Karadžić's thugs to orchestrate the burning and abandonment of Serb sectors of Sarajevo that were about to be handed back to the government. A substantial share of the vestigial hopes for a multiethnic Bosnia went up in that smoke. Smith, Holbrooke comments scathingly, "considered the civilian aspects of the task beneath him."

But the Pentagon's caution was ultimately self-defeating. "Paradoxically," Holbrooke writes, "the same officials who opposed capturing Karadžić usually supported a tight deadline for American troop withdrawal. The two goals were obviously incompatible; if you wanted to reduce troop levels quickly, capturing Karadžić was essential."

YUGOSLAVIA'S JUNKYARD DOGS

When Holbrooke met Mladić and Karadžić's during negotiations near Belgrade, he refused to shake their hands. "It is not an exaggeration to say that I simply hated the two men for what they had done," he writes. Holbrooke's feelings are particularly impassioned because three members of his initial team—Robert C. Frasure of the State Department, S. Nelson Drew of the National Security Council, and Joseph Kruzel of the Defense Department—were killed in an accident on a

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dangerous road that Mladić indirectly obliged them to take. But this rage does not extend to Milošević. One of the most frustrating aspects of *To End a War* is that Holbrooke never attempts an in-depth portrait of his main interlocutor, the man who, more than any other, propelled Yugoslavia to its death. What, one wonders, was it like for Holbrooke to shake hands with *him?*

This silence is troubling since Milošević is central to the prospects for Balkan peace, and his record is scarcely encouraging. His family background—both parents committed suicide—offers a macabre reflection of an image dear to many Serbs: that of Serbs as a people with a tendency toward, even a predilection for, self-destruction. Certainly destruction, of his own people and others, has been the overriding characteristic of Milošević's oeuvre. With chilling predictability, the work continues in Kosovo.

Karadžić and even Mladić were nothing without Milošević, who spent the late 1980s whipping the Serbs into the fever of nationalist indignation that led to the killing fields and concentration camps of Bosnia. Even in 1995, when Holbrooke wanted to know which Serb general would organize a promised Serb pullback from Sarajevo, it was the commander of Yugoslav forces in Belgrade who gave him the answer. Ultimate control, whatever the myriad obfuscations, always rested in the Serbian capital and its master.

By the time Holbrooke tangles with him, however, Milošević wants out of the war and the international trade sanctions that go with it. Herein lies his pivotal importance. The Serbian leader is a bully, but an engaging one. He calls the Bosnian Serbs "shit" (pronounced "sheet"); he smokes fat cigars; he sings along with Andrews Sisters songs at Dayton; he even gives away Serb claims to the city of Sarajevo at a crucial moment in the negotiations and says he will accept "rocks, swamps, hills, anything" as long as peace is made. Still, Holbrooke goes too far when he writes: "Watching Milošević turn on the charm, someone observed that had fate dealt him a different birthplace and education, he would have been a successful politician in a democratic system." Surely the very heart of a democratic system is a sense of human dignity and the value of human life. It was not communism that made Milošević so unfeeling, so manipulative, and so exceedingly cruel; it was something deeper. The hundreds of thousands of lives that he has extinguished or ruined have apparently never made the slightest dent on him. When over 150,000 desperate Serb refugees poured into Serbia from the Krajina, he did not address a word to them; and as for the camps through which several hundred thousand Muslims were processed in Bosnia, they never existed. Intriguingly, one of Milošević's favorite pastimes at Dayton was "visiting Bosnia" through the technology of PowerScene computers that recreated Bosnia's topography on a screen. Bosnia as plaything: a true Milošević image. In reality, of course, Slobo visited Bosnia only once and then slunk back across the Drina, leaving the ruins, the pain, and the spreading graves behind him.

Just before his death, Frasure got it exactly right. There was nervousness in Washington over the Croat offensive in the Krajina, but Frasure insisted that it had to continue in order to create a balance of power. He slipped a note to Holbrooke that read, "We hired these guys to be our junkyard dogs because we were desperate... This is no time to get squeamish." Because

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the West accepted the Serb barbarity of 1992 and never determined that the Serbs had to be defeated, it was left with the junkyard dogs—including Milošević, Croatian President Franjo Tudjman, and Iranian operatives smuggling arms to the Bosnian government—as its surrogate agents. The singular achievement of Holbrooke and his brave, dedicated team was to leash these dogs and forge a peace. But a junkyard pact so late in the day could scarcely be uplifting.

THE ABANDONMENT

Holbrooke writes that he now sees several flaws in Dayton. The agreement left two opposing armies—that of the Muslim-Croat federation, which controls 51 percent of Bosnia's territory, and that of the Bosnian Serbs, who hold the remaining 49 percent—in a single country. It allowed Karadžić's Serbs to keep the name "Republika Srpska" for their portion, a name synonymous with countless atrocities. It initially set an unrealistic timetable for NATO withdrawal, leaving "the impression among the parties, and especially the Serbs, that they might be able to outwait the enforcing powers." It created a police force far too weak, a NATO mission too circumscribed by the caution of its first commander, and an authority too diffused among powers including NATO, the United Nations, the U.N. High Commissioner for Refugees, the Office of the High Representative, and others. On top of all this, as Holbrooke acknowledges with painful honesty, "I realized too late that I had left too early." By leaving office within three months of Dayton, Holbrooke removed the single force, the one respected authority, most capable of rectifying the problems he outlines.

Nonetheless, the achievements of Dayton are enormous, and hope is not entirely extinguished. If Bosnia has a chance, it has Holbrooke to thank among American officials because he has cared from the outset. President Clinton has at last dropped the deadlines for the NATO force's presence in Bosnia; Lieutenant General Wesley Clark, Holbrooke's man on the shuttle, has become the supreme commander of a reinvigorated and now cohesive NATO that has taken a stronger stance in Bosnia; some war criminals, mostly minor figures, have been arrested; Karadžić is increasingly marginalized; a new spirit of cooperation with Dayton's provisions has taken hold in wide swathes of Serb-held Bosnia with the election in January of Milorad Dodik as prime minister of Republika Srpska; and an economic revival has begun in some parts of the country. Holbrooke, as he makes clear, has never stopped pushing for these developments, and he still believes that partition will be avoided and Bosnia made whole.

Holbrooke has become an open opponent of realpolitik, which he equates with Henry A. Kissinger's view that Bosnian partition is inevitable. One hopes Holbrooke is right, for Bosnia did indeed exist before the vultures from Belgrade and Zagreb descended. Its rich, variegated soul still lingers in those shadowy valleys. But there has been too much destruction over too long a period to hold out much hope that the country can now heal. The wounds are too deep and the hour too late. As Haris Silajdžić, the volatile Bosnian prime minister, observed at Dayton, "What you want would have been easier in 1992 or even 1993, but now it is too late. Where was the world then? Where was the United States?"

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Review Essay

All the President's Acumen

The Paradox of Nixon's Foreign Policy

David C. Hendrickson

A Tangled Web: The Making of Foreign Policy in the Nixon Presidency. BY WILLIAM BUNDY. New York: Hill and Wang, 1998, 672 pp. $35.00.

Uniquely among postwar presidents, Richard M. Nixon continues to be the object of hard and unforgiving feelings among historians of American foreign policy. Though all presidents have at times been treated harshly, none evokes the special animus reserved for Nixon. Scholars who regard the American involvement in Vietnam as a blunder of monumental proportions—and there are few writing today who do not—frequently treat the president who escalated the war, Lyndon B. Johnson, with real empathy, the scorn once reserved for LBJ having been displaced by a sense of the tragic compulsion that led a man with essentially decent political instincts to doom. The president who extracted the United States from that war, by contrast, is still hated. Since Nixon was a great hater himself, as he ruefully acknowledged in his touching farewell speech, there is perhaps a measure of cosmic justice in this state of affairs—with Divine Providence ensuring strict reciprocity in this as in all other matters. Whatever the reason, or reasons, the fact remains. Nixon is judged harshly; even his successes are often seen as proceeding from an essentially rotten heart.

William Bundy's exacting, intelligent, and formidable history of Nixon's record in foreign policy demonstrates that the hard judgments about the former president are by no means confined to the radical critics who drove him first to distraction and ultimately to ruin. The author is no radical, but a pillar of the liberal foreign policy establishment. In the 1950s he joined the CIA, then served in the 1960s at the assistant secretary level in the Departments of Defense (for international

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security affairs) and State (for East Asian and Pacific affairs). He was editor of *Foreign Affairs* from 1972 to 1984. He is broadly sympathetic to the essential features of post–World War II American foreign policy and even to many central features of Nixon's foreign policy. At the same time, he has written a biting and often savage indictment of Nixon and his national security adviser, Henry A. Kissinger. Under Bundy's microscopic examination, scarcely any feature of that record emerges unscathed. Time has not withered, nor custom staled, what is clearly a considerable animosity toward both men.

Bundy, it is true, treats with much generosity the Kissinger of the dark years of 1973-74, after he had become secretary of state, when the political mood was one of the utmost bitterness and serious crises pressed on all fronts. He praises Kissinger's shuttle diplomacy after the 1973 Yom Kippur War as masterful, echoing his complimentary treatment of the handling of the Jordanian crisis in 1970. He also clearly admires Kissinger's rear-guard action against the hard-liners, centered on Senator Henry Jackson (D-Wash.), who were indicting Kissinger for appeasement on arms control and the emigration of Soviet Jews. But what praise there is for the overall record is meted out sparingly, appearing as little oases of commendation amid a desert of condemnation. Bundy's larger judgment emphasizes that Nixon and Kissinger continually deceived the American public and Congress; out of these deceptions flowed the major mistakes in policy (the "tangled web") in which they were subsequently entrapped. Watergate, though emblematic of Nixon's deceit, was not the primary cause of the collapse of the administration's policy from 1973 to 1975. The real reason was that its vaunted "structure of peace" had been "oversold, timed and framed too much for domestic political effect." The administration is alleged, in effect, to have kept three sets of figures: one to mislead the public, another to mislead the Congress, and the third to mislead itself.

THE INDICTMENT

Among the many allegations brought against the administration are that Nixon "personally organized in 1968 a covert operation to persuade Nguyen Van Thieu to defer joining in the peace talks—the very act that may have tipped the [1968 U.S.] election result in Nixon's favor"; that Nixon never challenged Thieu's choice of commanders in South Vietnam, which might have made a real difference, because of the debt so incurred; that the Cambodian incursion of 1970 was counterproductive to the larger policy of Vietnamization and disastrous for Cambodia, part of a series of missteps that place the responsibility for the mass killing that befell that country after the 1975 Khmer Rouge victory squarely on Nixon and his advisers; and that in the period leading up to the Paris peace accords of January 1973 the administration treated the North Vietnamese with bad faith and brutality and the South Vietnamese with contemptuous disregard, while deceiving the American public with Nixon's secret and unconstitutional pledge to Thieu to resume bombing in the event of a major North Vietnamese violation of the peace accords.

The traits that distinguished the administration's approach to Indochina,

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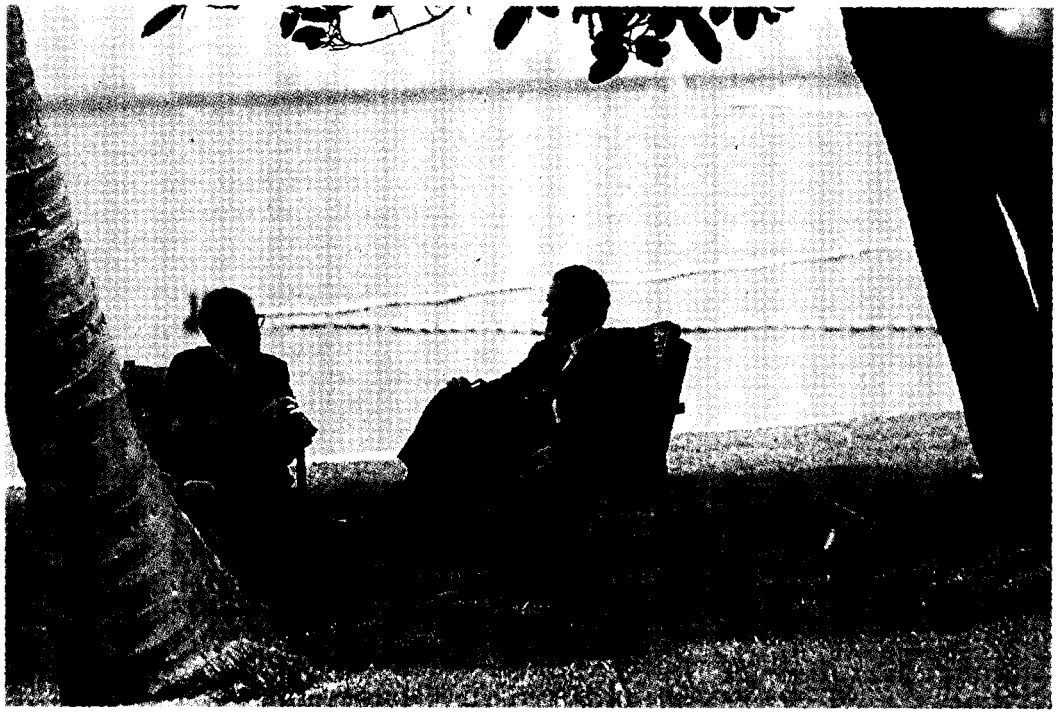

CORBIS-BETTMANN

Still controversial after all these years: Nixon and Kissinger in Key Biscayne, Fla., 1973

Bundy argues, were also on display in its policies toward Chile, Iran, and the Asian subcontinent. Though Bundy absolves the administration of direct responsibility for the coup against Salvador Allende in 1973, he castigates the covert and violent measures against the Chilean regime approved in 1970, casts strong doubt on Kissinger's assertion that they were countermanded, and insists that even in 1973 the administration might be fairly indicted for indirect responsibility because it so clearly welcomed the action by the Chilean military. Policy toward Iran, which in effect gave the shah carte blanche for military purchases from the U.S. arsenal, prepared the ground for the harsh anti-Americanism of the Iranian Revolution, while the dispatch of a carrier task force to the Indian Ocean in 1971, in the midst of the war between India and Pakistan, probably played a key role in India's decision to acquire nuclear weapons. Throughout that crisis, Bundy concludes, Nixon and Kissinger "lurched to highly doubtful conclusions on the basis of fragmentary evidence, little understood the decisive regional elements, and misjudged the conduct of both the Soviet Union and China at key junctures," leading to a policy "replete with error, misjudgment, emotionalism, and unnecessary risk taking."

Whereas policy in all these areas had grave consequences, the administration's policy toward the Soviet Union was often simply inept. In the Strategic Arms Limitation Talks (SALT), Bundy holds, Kissinger was continually sloppy. His blunders included a cynical political maneuver that feigned a willingness to negotiate limits on multiple independently targetable reentry vehicles (MIRV) technology, an unwillingness to explore with

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Ambassador Anatoly Dobrynin the bases of a mutual framework for controlling nuclear arms, and an unaccountable failure to link offensive and defensive limitations until early February 1971. Détente, Bundy believes, was for Nixon little more than a ploy intended to secure his reelection in 1972, but a policy for which the administration nevertheless had expectations that were doomed to be disappointed (for neither Russia nor China provided any real help in extracting the United States from Vietnam).

The real success of détente was the European version, emphasizing human rights, rather than the American, centered on geopolitics. Indeed, the Nixon administration never grasped the importance of Willy Brandt's policy, often bitterly criticized it, and misunderstood the part played in Soviet policy by concern about the future of Germany (even though, Bundy notes with a gasp of disbelief, Kissinger absurdly took credit for the achievements of the European détente in his eulogy of Nixon).

The opening to China was brilliant theater, and Bundy even allows that the understanding that Kissinger reached with Zhou Enlai over Japan, reflecting Chinese acceptance of the U.S.-Japan alliance, was of great importance. But it was a big blunder to have informed Japan at the last moment, profoundly embarrassing its government and destroying the trust that had been built up for a generation. Given the sheer inevitability of such a normalization, as well as the limited benefits obtained thereby, the opening was not quite the virtuoso performance alleged by the administration's defenders; besides, Kissinger found the answer to all the really difficult problems, like Taiwan, in State Department memoranda of the 1950s.

The heroes of this book are the unsung bureaucrats who were continually slighted and cut out of the policy process by the White House but who, Bundy argues, often gave more prescient assessments and better policy advice. Thus Marshall Green, assistant secretary of state for East Asian and Pacific affairs, expertly forecast the folly of invading Cambodia—and was punished for being right. Gerald Smith, chief SALT negotiator, was cut out of the action before and during the final stages of the negotiation over offensive nuclear forces, with predictably negative results. The State Department's Berlin experts were not the "sterile theologians" of Kissinger's description but professionals with a far better grasp of the European situation than either Nixon or Kissinger. Bundy also lavishes high praise on the economic diplomacy of the administration, particularly the patient method of consultation with Congress and allied governments employed by George Shultz after he became secretary of the treasury in 1972, pointedly contrasting it with the deceptive end runs made by Kissinger.

A PHILOSOPHICAL DEEPENING

The power of this indictment, and the skill with which Bundy marshals his evidence, cannot be gainsaid. It is nevertheless flawed. For all the emphasis on Nixon and Kissinger's deceit, there is much that this book leaves hidden: the polished foreign policy reports prepared under Kissinger's direction hardly merit a mention, much less a fair exposition. Yet the words of the administration were important. Nixon and Kissinger introduced

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to the dialogue over the nation's foreign policy a new sophistication that did represent what Kissinger called a philosophical deepening. Their outlook accepted much of the previous liberal critique of universalism, yet cast the new approach in the classic idiom of European statecraft. America, they contended, could neither withdraw from nor dominate the world; instead, it would have to accept its necessary role as a stabilizing factor in the maintenance of a balance of power, without which there could be neither peace nor justice. The Nixon administration's policy, it might be argued, often sounded better than it was, but a careful historian should recall the words and give them their due.

Bundy's desire to cast the two men into perdition leads him frequently to overstatement. It is misleading, for example, to leave the impression that the Nixon administration was positively hostile to Brandt's Ostpolitik. Giving vent to suspicions in private is not the same thing as opposing in public. Privately, both men did indeed worry that Germany would get too far ahead of its allies and be tempted to cut a separate deal with the Soviet Union. Their considered policy, nevertheless, was not to derail but to guide Ostpolitik by embedding it "in a wider framework than German nationalism," as Kissinger noted in his memoirs.

Nor is it fair to chide the administration for failing to move "out of the mold of the Cold War." Such an enterprise, like the tango, is best not undertaken unilaterally. When the American presidency suddenly weakened in 1973 and 1974, the Soviet Union proved a most coy and unwilling partner (as was seen in its continuing military buildup and its growing adventurism in Africa and the Middle East). Bundy is right to stress that Europe's mid-1970s détente with the Soviet Union represented an important structural change, for contact with the free societies of the West did in the end introduce a fatal contagion into the communist system. But that détente, culminating in the 1975 Helsinki accords, was largely brought about in conjunction with rather than in opposition to the United States and would not have been as successful as it was without the corresponding U.S. insistence that a balance of military power was also indispensable.

Bundy's account of Kissinger's oversights, failures, and sloppiness in negotiations over nuclear weapons is also tendentious. As Kissinger himself has conceded, the methods employed in the Nixon administration—the "weird" administrative style of the White House, the studied isolation of the foreign affairs bureaucracy—are not "desirable in the abstract; certainly, they should not be regularly pursued." Bundy does show that certain mistakes followed directly from that style, but he does not show that those mistakes were really all that consequential. The Nixon administration's policy must stand or fall on the 1972 Antiballistic Missile Treaty, whose lasting significance was the acceptance of mutual vulnerability, yet Bundy says little about the importance of that agreement. Conceding, as he does, that it would have been almost impossible for any administration to stop the momentum toward MIRVs and precision guidance in the late 1960s or early 1970s, which so complicated arms control efforts over the next two decades, the indictment of Kissinger must center on certain

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marginal features of the numbers game related to strategic nuclear weapons. Later in the book, Bundy all but acknowledges that the numbers game was essentially meaningless.

The grand design that Nixon and Kissinger put forth in the first term—symbolized by "triangular diplomacy" and "the new structure of peace"—had more coherence and integrity than Bundy is willing to allow. Their moves to open an era of negotiation with both communist powers and to de-emphasize the ideological warfare of the preceding generation gave American diplomacy considerable flexibility and resilience, constituting valuable warnings against the overreaching of the previous epoch and important insurance against the prospect of the unilateral abdication that then beckoned.

Linkage, it is true, introduced through the back door the fixation on ideological considerations that had been banished at the front, and Bundy's criticism of the Chilean episode—a discreditable instance of this strange displacement—is just. Still, the overall framework then established was a sound one, which is why American diplomacy kept returning to it over the next 20 years. The strategy of offering to the Soviet Union both inducements and restraints did not constitute a miracle cure for superpower competition (what could?), but it still seems in retrospect a more sensible formula than that offered by the Congress of that era. That formula, increasingly, seemed reducible to denying the administration both carrots and sticks in its approach to the communist world, yielding a diplomacy that was not made for peace and a military posture that was not prepared for war.

"Peace with honor" also, of course, ended ignominiously, and doubtless the Nixon administration must take much of the blame. But blame also falls on Congress, which irresponsibly cut the South Vietnamese off from the supplies of ammunition and fuel that were desperately needed in 1974 and 1975. The assessment of responsibility in Cambodia is also, I think, much more difficult than Bundy allows. The alternative scenario that he suggests might have unfolded had the United States respected the Cambodian sanctuary (a North Vietnamese rather than Khmer Rouge takeover of Cambodia) seems quite implausible. Even if right, isn't it a classic case of wisdom after the event? Many critics of the Cambodian incursion in 1970 stressed the illegality of the measure; those whom Bundy cites approvingly (like Green) stressed that it would prove counterproductive to the larger policy of Vietnamization. None predicted that it (or later missteps) would give rise to a chain of consequences that would end with a genocidal regime in power in Phnom Penh in 1975. Americans should certainly reflect deeply and sorrowfully on the nature of the responsibility their country bears for that catastrophe, even if the consequences were unintended and the responsibility was partial. Still, those who advised that we should wash our hands of the entire business and let events take their course are really in no position to hurl down thunderbolts at those who counseled resistance to a communist takeover.

"The test of a first-rate intelligence," in F. Scott Fitzgerald's oft-quoted words, "is the ability to hold two opposed ideas in the mind at the same time, and still retain the ability to function." Certainly

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such an ability is useful in coming to terms with Nixon and Kissinger. They are truly a study in contradiction. Not for nothing has "Nixonian" passed into the language as an adjective designating low methods and deceptive tactics. There is impressive evidence that Kissinger, too, acted in ways that well earned the distrust and enmity of former colleagues and associates. But the dark side is not the whole truth about either man. Nixon may have been, as Bundy alleges, a " 'true believer,' fervent, intolerant, sure of his own positions," but he could also be a very shrewd observer of the political world. Kissinger, as *The Haldeman Diaries* made clear, may have acted in an extraordinarily petty fashion on some occasions, but he also displayed elements of true greatness as a statesman. It is a strange irony indeed that Kissinger, who may be found on occasion both well below and well above the mean of virtuous conduct—alternately resembling, as it were, both the beast and the god of Aristotle's description—should be most identified with, and have given us such profound explications of, the philosophy of equilibrium in international relations.

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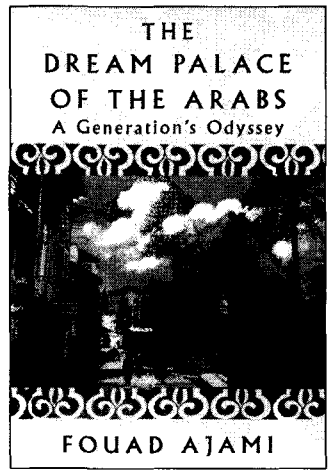

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Response

Stick with Kyoto

A Sound Start on Global Warming

Stuart Eizenstat

In his critique of the recent Kyoto accord, Richard N. Cooper notes that mitigating climate change will not be easy ("Toward a Real Global Warming Treaty," March/April 1998). He argues that allocating greenhouse gas emissions rights among nations, especially in the developing world, is impractical. Since economists' favorite solution to problems such as emissions is to tax the offending activity, he concludes that a more practical solution would be to have all countries agree on a common carbon emissions tax.

Cooper is right about one thing—fighting global warming will not be easy. Setting differentiated emissions targets among countries with widely diverse histories and national circumstances will be especially difficult. Indeed, Kyoto is one of those ideas that can easily be criticized—until you consider the other options. Cooper's alternative is to create an international obligation to impose energy taxes. But his belief that agreeing on such a tax might be easier than setting emissions targets is out of touch with political reality. Even if it could be arranged, an international obligation to tax emissions could not be expected to work well.

REMEMBER EL NIÑO

Cooper, one of my predecessors in my current position, is skeptical about global warming, referring to it as an "alleged problem." But the matter is serious indeed and requires a concerted international response. Atmospheric concentrations of carbon dioxide, the most important greenhouse gas, are currently about 30 percent above preindustrial levels. Unless we change course, concentrations in 2100 are predicted to reach levels not seen in more than 50 million years.

The authoritative Intergovernmental Panel on Climate Change (IPCC), com-

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posed of 2,500 scientists worldwide, warns that global warming will harm human health and cause significant loss of life. Potential problems include a rise in the sea level, the spread of infectious diseases, droughts, and floods. For a preview of the type of severe weather in the warmer, wetter world that climate change would bring, look at the devastation wrought by this winter's El Niño. Without policy intervention, the IPCC warns that average global temperatures will increase between 2 and 6.5 degrees Fahrenheit by the end of the next century. By then, average July temperatures in Washington, D.C., will have risen by 5 to 15 degrees, with greater humidity. By comparison, average global temperatures during the last ice age were only about 9 degrees colder than today.

Many, including Cooper, have noted the significant uncertainties associated with global warming, the impact of which will vary from region to region. What is clear, however, is that unless we take action, we will be conducting an unprecedented experiment with our planet. We risk endangering our children and grandchildren. Rational policymakers do not wait until every doubt is resolved before moving. The Kyoto protocol is like an insurance policy: its modest premiums protect against risks that will cost much more to mitigate if the world waits to act.

A GLOBAL TAX WON'T WORK

Cooper's tax proposal is politically impractical and substantively unsound. The United States fought hard and successfully at Kyoto to avoid mandatory measures like an international tax.

To my knowledge, no international agreement has ever imposed an obligation on countries to tax their citizens. This is hardly surprising. An internationally mandated tax would combine two unpopular ideas: paying more of one's money to the government and surrendering part of national sovereignty to an international body. Moreover, energy taxes are anathema in the United States. It would be hard to find a policy that would face greater political hurdles.

Even putting political reality aside for a moment, a common international tax is a bad idea. Countries with existing energy taxes could reduce them while a new international carbon tax was imposed on countries without preexistent energy taxes. The net effect would be little, if any, reduction in emissions. Assuming such behavior is not prohibited by the international regime, the United States, which has relatively low energy taxes, would face a disproportionately large share of the burden. And even if the international system were to prohibit reductions in energy taxes, countries could offset the impact of a new carbon tax indirectly, through other changes in tax or subsidy policies (say, rebates on specific taxes or increases in highway construction financing), while ostensibly maintaining their existing energy taxes. Distinguishing permissible from prohibited policies would be extraordinarily difficult and could bring unacceptable international scrutiny to domestic tax decisions.

Moreover, Cooper fails to see that a system of tradable permits can be as efficient as a tax. If one firm is able to reduce emissions cheaply while another finds it difficult to do so, the first will be able to sell permits to the second, thereby reducing the overall cost of achieving the environmental objective. According to the 1997 Economic Report of the President, the choice between

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fees and marketable permits is of secondary economic importance. Over 2,500 economists have signed a letter stating, "In order for the world to achieve its climatic objectives at minimum cost, a cooperative approach among nations is required—such as an international emissions trading agreement." That is precisely the logic behind, and the promise of, the Kyoto agreement.

KYOTO'S VIRTUES

Kyoto is still the best basis for action, for three reasons. First, the protocol adopted differentiated targets, recognizing that each country must address climate change based on its own national energy profile and circumstances—a particularly crucial point for developing countries.

Second, Kyoto lets countries pursue their own paths to lower emissions. In one country, that might be an energy tax. In the United States, President Clinton has called for a domestic trading system (to begin by 2008) of the kind that has worked so well, both environmentally and economically, in reducing acid rain.

Third, Kyoto embraces market-based international mechanisms. As noted above, emissions trading is central to achieving Kyoto's goals at modest cost. In addition, the Clean Development Mechanism—which will allow companies in the industrialized world to invest in "clean technology" projects in developing countries and share the credits from reduced emissions—has the potential both to lower costs for U.S. companies and to encourage the transfer of environmentally friendlier technology to developing nations.

Cooper argues that the Kyoto approach cannot work without the participation of developing countries, who will not join in because they will agree neither to an allocation of emission rights nor to constraints on their economic growth. He is half right. Kyoto cannot succeed, either environmentally or politically, unless key developing countries participate. Climate change is a global problem and requires a global solution. Indeed, the president has stated clearly that he will not submit the treaty for ratification without participation by key developing countries. But Cooper is overly pessimistic about the chances that developing countries will join in. Despite the difficulties at Kyoto, several key developing countries did indicate an interest in participating. A comprehensive diplomatic strategy will engage still more.

To be sure, winning over developing nations will not be easy, but Kyoto contains several incentives for them. Efforts to mitigate climate change will help address their more immediate pollution problems. Furthermore, developing countries are the most vulnerable to the dangers of global warming and the least able to protect themselves. Perhaps most important in the short run, the worldwide effort to address global warming can help developing countries economically as well as environmentally. Whenever developing countries take on Kyoto commitments, they will be able to participate in the international emissions trading system, reducing costs and perhaps even generating revenue. Kyoto can help developing nations grow sustainably, without constraints, and by a different energy path than that of countries that industrialized earlier. Sustainable economic growth must be environmentally sound.

Global warming is not a problem we will solve in this decade or this generation. The innovative Kyoto framework should be built on, not discarded.

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Illiberal Illusions

Restoring Democracy's Good Name

Democracy First

CHARLES A. KUPCHAN

Fareed Zakaria warns that the rise of "illiberal democracies"—states that hold free elections but do not honor the rule of law and the rights of their citizens—calls into question one of the core goals of American foreign policy: exporting democracy ("The Rise of Illiberal Democracy," November/December 1997). It is not democracy alone that makes states peaceful and benign, Zakaria contends, but liberal democracy. Without the protection of individual rights and the constraints on centralized power that accompany constitutional liberalism, democracy is prone to abuses of power and, especially in diverse societies, ethnic rivalry and conflict. Only when democratic governance evolves amid preexisting liberal protections does it lead to the oft-heralded "democratic peace." With half of the world's democracies illiberal, the spread of elections, far from producing a more harmonious world, is leading to increased instability. Zakaria counsels U.S. policymakers to end their fixation on ballot boxes and emphasize reviving constitutionalism and the rule of law.

Although on target in his observation that illiberal democracy is on the rise, Zakaria misses the mark in explaining why and in prescribing what to do about it. He misconstrues how liberal democracy evolves by relying too heavily on the Anglo-Saxon experience. Classical liberalism—the notion that the individual's autonomy is sacrosanct—was born and bred in Britain and the United States. When democracy—narrowly defined as the selection of governments through free and fair elections—took root in these countries, their political cultures, practices, and institutions were already imbued with the spirit of constitutional liberalism. Zakaria is right that liberalism preceded democracy—but only in the Anglo-Saxon West.

The current wave of democratization is taking place in regions that have little or no experience in constitutional liberalism. Many countries in East Asia and the former Soviet bloc, for example, have a long history of paternalism and social norms that privilege the group over the individual. Without a tradition of liberal protection, the introduction of democracy is critical to instilling respect for individual rights and values of accountability and responsibility. Participatory democracy

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helps bring about the incremental changes in political culture necessary for liberal governance. Constitutional liberalism, after all, rests not just on formal institutions, but on the political attitudes and habits that bring them to life. Furthermore, the abuses of power that accompany illiberal democracy often create demand for the institutions and practices that check centralized power. In many of today's democratizing states, illiberal democracy may be a way station along the road to the more benign forms of governance that Zakaria justifiably prefers.

PUTTING THE CART BEFORE THE HORSE

Zakaria attempts to rebut the claim that democracy can foster liberalism by arguing that "democracy does not seem to bring constitutional liberalism," and that "to date few illiberal democracies have matured into liberal democracies." Not so. In fact, many of today's liberal democracies passed through lengthy illiberal periods. Germany had to make several passes at democracy before getting it right—the Wilhelmine and inter-war variants were far from liberal. Even after the United States exported constitutional liberalism to Germany after World War II, it took time for it to take hold. Japan has long held democratic elections but has only recently strengthened multiparty governance, the quality and scope of public debate, and other attributes of liberal systems. A number of Latin American states have moved—admittedly in fits and starts—from illiberal to liberal democracy. Mexico, for example, has been democratic for decades, during which time its commitment to constitutional liberalism has gradually deepened. Democracy may produce adverse side effects during its early, transitional years, but over time it helps instill habits of transparency, tolerance, and accountability conducive to stable and liberal governance.

Zakaria's misconception that liberal democracy takes root only when constitutional liberalism precedes democratic rule leads him to misinterpret the political transformations now taking place in many parts of the world. East Asian states are relatively wealthy and stable, according to Zakaria, because they have followed the Western itinerary and moved from "autocracy to liberalizing autocracy, and, in some cases, toward liberalizing semi-democracy." Most East Asian states, however, are far more democratic than they are liberal. In Zakaria's own terms, constitutional liberalism "seeks to protect an individual's autonomy against coercion, whatever the source." But in making the case for East Asian liberalism, Zakaria points primarily to the existence of free markets, contract law, and property rights. East Asians might enjoy the wealth that has accompanied these economic freedoms as well as the moderating influence of a growing middle class, but they certainly do not enjoy the civil liberties commonly associated with liberal governance. Even in the economic realm, states assert control over the market—one of the main causes of the recent financial crises in East Asia. Civic freedoms have of late been expanding, especially in South Korea and Taiwan. But democracy has served as a beachhead for liberal values and practices, not vice versa.

BUILDING GOOD HABITS

Zakaria rightly notes that in Africa, Central Asia, and the Balkans, rapid democratization has contributed to the

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rise of illiberal regimes and "in divided societies has actually fomented nationalism, ethnic conflict, and even war." But how, if not through the introduction of democracy, is civil society to gain a foothold in states that suffered for decades under authoritarianism and have no tradition of constitutional liberalism? How are individuals to win the respect of the state if they are not even accorded the right to vote? And how is the state to win the respect of its citizens if they have no say in its governance? The institutions that limit power in liberal systems will ring hollow without the reconciliation between state and society that democracy fosters.

For example, postwar Bosnia's first round of elections in September 1996 strengthened hard-liners and made a mockery of the institutions designed in the Dayton Accord to repair communal ties and distribute power equitably among Muslims, Croats, and Serbs. But if a multiethnic Bosnia is to survive, democratic processes must be given a chance to lend legitimacy to government institutions, nurture individual responsibility and accountability, and promote a shared sense of civic identity. Elections that lead to abuses of power or reinforce ethnic tensions may well be necessary evils along the path toward liberal democracy. Indeed, the most recent round of elections late last year weakened the main nationalist party in the Bosnian Serb parliament, suggesting that a more moderate center is emerging.

Zakaria's failure to distinguish between the formal institutions of constitutional liberalism and the political habits that are the lifeblood of liberal governance also leads him to misread Central Europe. Because they were liberal autocracies during the nineteenth century, he contends, Poland, Hungary, and the Czech Republic are now liberal democracies. But although these countries have regular elections and liberal constitutions, they have a long way to go in building liberal societies. After decades of repressive rule, many Central Europeans still see the state as an adversary, not a legitimate and impartial authority. That is one reason many Hungarians do not pay their taxes. The Hungarian press is nominally free, but most newspapers are mouthpieces for political parties, and the government still exercises considerable control over broadcast media. Central Europe's economies, although largely privatized, suffer from corruption and opaque business and accounting procedures. The practice of constitutional liberalism will catch up with the form only as democratic habits deepen and society and the state gain mutual respect.

Zakaria concludes by appearing to pull back from his insistence that liberalism must precede democracy, instead acknowledging that the two may go hand in hand. He sensibly urges American policymakers to promote both liberalization and democratization. Nevertheless, the central thrust of Zakaria's analysis is clear: the United States should stop pushing the ballot box until states are liberal enough to make good use of it.

To recast U.S. policy accordingly would be misguided and dangerous. Constitutional liberalism cannot be imposed upon a society that lacks the requisite political values and habits. Instead, participatory democracy is essential to nurturing the dignity and autonomy of the individual, which is in turn the foundation of constitutional liberalism. Were the United States to stop promoting democracy, it would find the

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world not just less democratic but also less liberal—and in the long run less peaceful. Bringing about the "democratic peace" may require the spread of liberalism, as Zakaria argues, but it is the initial spread of democracy itself, even in its illiberal forms, that will eventually get us there.

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Election Realities

JULIANA GERAN PILON

Fareed Zakaria refreshingly and rightly warns against the equation of elections with liberal democracy and revives the Madisonian truism that unfettered democracy can be dangerous to the cause of individual freedom. Unfortunately, he goes too far, proceeding from the statement that elections are insufficient for the creation of a liberal system to warn that votes may be dangerous. His conclusion runs counter to the realities of post-authoritarian, and specifically post-communist, nation-building.

Zakaria claims that "without a background in constitutional liberalism, the introduction of democracy in divided societies has actually fomented nationalism, ethnic conflict, and even war." In fact, elections in the former Soviet bloc made possible a bloodless revolution. Contrary to Zakaria's expectations, the leaders brought to power in the first post-communist elections were by no means extreme nationalists. Trouble spots were rare. The June 1997 elections in Albania ousted an unpopular president, letting reform proceed and largely stopping the killing. The 1996 Bosnian elections have encouraged what may yet be a peaceful, if admittedly volatile, evolution. Indeed, the newly elected president of the Bosnian Serbs' Republika Srpska, Milorad Dodik, is an avowed moderate.

Democracies can certainly trample on liberties, and constitutional guarantees are necessary to protect the rights of minorities. Who can doubt that it would be a blessing if all nations had been as lucky as America, which adopted a Lockean system of checks and balances almost from the outset? But reality does not always comply with theory.

Zakaria argues that liberalism must precede democracy for liberal democracy to result. But what does this mean for countries that already have some measure of democracy but little in the way of constitutional liberties? For six years, Ukrainians nervously led their fledgling democracy without a constitution, the operative Soviet-era parchment being worse than nothing. The constitution that was finally passed in June 1996 was the result of compromise rather than philosophical purity, but it is acceptable. Would Zakaria have had them wait until it was completed before they could proceed with elections? Sometimes the ship of democratic liberalism must be built while sailing on the tempestuous waters of history. This has been true for every post-totalitarian nation; Poland, the cradle of Solidarity, which pioneered organized dissent in the Soviet bloc, just passed its constitution this year. The interim constitution was flawed at best; nor is its successor a perfect document. But the process goes on, and it will get better. Zakaria seems uncomfortable with such imperfection; building

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ships while sailing is not his idea of neat political development.

Zakaria cites Central Asia as one important region where "elections, even when reasonably free, as in Kyrgyzstan and Kazakstan, have resulted in strong executives, weak legislatures and judiciaries, and few civil and economic liberties." But consider the facts in context. The national elections of 1995 may have been "reasonably free" but they were definitely problematic. Some reforms have already been introduced, but there is a need for more. Both countries' presidents are surely powerful, but there is no indication that they preside over unstable populations or ethnic minorities ready to explode. As for civil and economic liberties, there has been some progress in both countries. In July 1997, Kazakstan privatized the majority of shares in three-quarters of its 2,500 medium-sized companies, adopted the most radical pension reform program in the former Soviet Union, and initiated major economic reforms to encourage foreign investment. Setbacks notwithstanding—notably in the freedom of the press—Central Asian nations appear closer to implementing "constitutional liberalism" today than they were three years ago. Blaming elections for current problems, rather than seven decades of communism, is mystifying.

Elections are not a panacea, and individual freedom must be protected by a strong constitution. Hopefully, each election held after the fall of an authoritarian system will be better than the one preceding it: the press freer, the electorate better educated, and the elected representatives more willing to pay heed to their constituents. In the real world of democracy-building, this is usually what happens. Unfortunately, it seldom grabs newspaper headlines.

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Pacific Democracy

NIGEL GOULD-DAVIES

Zakaria dwells on the usurpation of power by democratically elected leaders as an example of illiberal practice. This, though, is illiberalism as the violation of the separation of powers rather than of citizens' rights. It may be a bad thing that President Askar Akayev of Kyrgyzstan has created a very strong executive, but this is a debate about the merits of different democratic designs rather than the altogether more serious matter of the infringement of individual freedoms. Democratic power can be organized in many different ways, but it makes little sense to say—without examining particular cases—that some arrangements are inherently less liberal than others.

Furthermore, taken far enough, the usurpation of power itself undermines democracy. Even Zakaria concedes that Alberto Fujimori's disbanding of Peru's parliament "makes it difficult to call his regime democratic." This is a democratic leader behaving undemocratically, not illiberally. The same could be said of Alexandr Lukashenko in Belarus. It is undoubtedly interesting and significant that democracies can abolish themselves in this fashion. But when such regimes subsequently violate individual rights, they are doing so not as democracies but as ex-democracies. Incidentally, it should be noted that "constitutionalism" is not a

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concept that can be appropriated by liberalism alone. Constitutions enshrine not only individual rights but democratic mechanisms, and the abrogation of the latter is as unconstitutional as the violation of the former.

Zakaria argues that the introduction of democracy in divided societies can foment "nationalism, ethnic conflict, and even war." But the fact that populist nationalism and ethnocentrism can be inflamed and put to violent uses by leaders of limited accountability does not mean that democracy itself invokes these malign forces. In most instances, nationalism exerts its influence through public expression, not democratic voice. To say otherwise is to confuse the passions of the masses with the power of majorities. Indeed, nationalism has often been manipulated from above as a strategy for averting, not responding to, democratization.

Moreover, since the propagation of nationalist sentiments requires a degree of freedom of speech and assembly, it may in fact be liberalization rather than democratization that makes states more dangerous. Such a conclusion is supported by the argument that an imperfect "marketplace of ideas" fosters the spread of nationalist myths. The expansion of liberal freedoms, not democratic accountability, makes possible the articulation of identity and difference for invidious ends.

Even where democratization does provoke nationalist conflict, research suggests that this is a consequence of a specific path rather than the general process of democratic transition. The scholars Juan Linz and Alfred Stepan have shown that the sequence of elections crucially influences the mobilization of nationalist forces. Where regional elections precede federal ones, political identities and agendas crystallize around ethnic, nationalist themes and can threaten state integrity, whereas "if all-union elections are held first, there are strong incentives for political activists to create all-union parties, and an all-union agenda."

Liberal autocracies have a long record of conflict with each other; liberal democracies do not. In the last century, European states of the former kind intermittently took up arms against one another and ultimately—and disastrously—threw themselves into a general conflagration. Since the middle of this century Europe's states have been of the latter kind. They overcame the security dilemma and rendered war among themselves unthinkable. To be sure, other factors have been at work: the growth of interdependence, the bonding effect of the Cold War. But the distinctive, pacific effect of democracy on even hitherto liberal states appears striking.

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Where's the Cure?

KENNETH CAIN

Zakaria's diagnosis of the illiberal democracy virus is acute, but he offers precious little by way of cure. Anyone who has participated in chimerical U.S.- or U.N.-sponsored good governance initiatives would understand why: most of these programs simply don't work. As Zakaria points out, exporting democracy is much easier than exporting the rule of law. Constitutional liberalism requires the good faith of such a wide range of actors that addressing only one component

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is fruitless. For example, in the realm of criminal justice alone, reform requires an independent and highly educated judiciary, competent prosecutors, an active defense bar (who is going to pay for the defense lawyers?), well-trained and ethnically representative police, humane corrections staff and an appropriate prison infrastructure—all of which require substantial investment in universities and professional academies. The cost of creating and maintaining this system would overwhelm many poor democracies, not to mention take several decades to develop fully.

Moreover, the last thing many illiberal though democratically elected regimes want is an independent judicial system—an anathema to unfettered power. Reform programs in Cambodia and Haiti have failed badly due to these hard realities. Meanwhile, Congress has savagely cut funding for aid programs. Unfortunately, the investment in dollars and the level of good faith required to overcome obstacles to constitutional liberalism in many of the poorest democracies imply that the illiberal virus will continue to attack and infect weak cells of democracy.

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Recent Books on International Relations

Political and Legal

FRANCIS FUKUYAMA

Twilight of the West. BY CHRISTOPHER COKER. Boulder: Westview Press, 1998, 203 pp. $28.00.

The "West" in the title of this book is not Western civilization but the Atlantic community that was to be the political-cultural basis for the NATO alliance. The author, in a sophisticated piece of intellectual history, explains that this community had to be deliberately constructed in the postwar period and never achieved the emotional allegiance, particularly on the European continent, to make it a durable unit without the Soviet threat. From the beginning there was a competing, French-inspired vision of European identity that did not include the Americans, and by the end of the Cold War all of the countries involved were undergoing a demographic evolution in the direction of multicultural societies that would have little by way of common culture. Coker is, not surprisingly, pessimistic about the political alliance's prospects for survival.

Paths to Peace: Is Democracy the Answer? EDITED BY MIRIAM FENDIUS ELMAN. Cambridge: MIT Press, 1997, 526 pp. $25.00 (paper).

This book constitutes the latest round in the recent debate over the relationship between democracy and peace—a debate that, in contrast to many academic arguments, has been rich, fruitful, and full of policy consequences. This book argues that democracy is only one of several domestic political factors, such as leadership orientations, civil-military relations, and the like, that determine the likelihood of a state to go to war. The book adds greatly to the fund of empirical knowledge on the subject since its case studies cover many less studied conflicts, such as Peru versus Colombia or Anglo-French relations under the July monarchy. Reasonably, it concludes that while there is indeed something to the correlation between

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democracy and peace, it is important to identify the specific conditions under which it is most likely to apply. One issue should have been dealt with at greater length: the authors on both sides of the argument tend to conflate democracy and liberalism. But as Fareed Zakaria has written in these pages lately, the two are theoretically and pragmatically separable forms of governance, and a stronger argument could be made for a liberal rather than a democratic peace, as originally argued by Michael Doyle.

The Character of Nations: How Politics Makes and Breaks Prosperity, Family, and Civility. BY ANGELO M. CODEVILLA. New York: Basic Books, 1997, 340 pp. $27.00.

This book begins from the now-forgotten premise of Plato and Aristotle that different regimes produce different types of human beings; indeed, that regimes ought to be judged by the character of their citizens. The author surveys a number of contemporary societies and notes how, particularly in Europe, the growth of an interventionist welfare state has done damage to habits of entrepreneurship, fostered dependence, undermined families, and promoted values at odds with those of traditional religious teachings. The same is happening, he fears, with the rise of the welfare state in the United States.

Codevilla does a good job of demonstrating the social effects of policy, noting, for example, that egalitarian Swedish policies toward women have virtually destroyed the Swedish family. He fails, however, to distinguish between the underlying regime and the liberal policies that have been enacted by particular administrations. It is not clear that the American regime or American political culture have changed that much since the New Deal: Americans remain far more religious and individualistic than their European counterparts, and hence have been much quicker to rein in and even dismantle parts of the postwar welfare state in the 1980s and 1990s. Moreover, many of the trends that Codevilla dislikes—promotion of individual choice over the communal authority of families, workplaces, and military organizations—are deeply embedded in the Lockean liberalism on which the American state was based. The book's emphasis on the failings of liberal policies paradoxically overstates the power of social engineering to overcome these broader cultural trends.

Theologians of a New World Order: Reinhold Niebuhr and the Christian Realists, 1920-1948. BY HEATHER WARREN. New York: Oxford University Press, 1997, 199 pp. $39.95.

With mainline Protestantism's decline in recent years, it is easy to forget the important role that a group of activist Protestant theologians, including Henry P. Van Dusen, John Bennett, Francis Miller, and the brothers Reinhold and H. Richard Niebuhr played in the 1930s and 1940s arguing for a realistic Christian foreign policy. These men legitimated the deployment of power by democratic societies against fascism and laid the groundwork for an internationalist postwar posture. It is a shame that this otherwise insightful book stops short of examining two contradictions within the Christian realist tradition: first, its often less than realistic appraisal of the Soviet Union later in the Cold War, and second, the

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difficulty that religious groups have in maintaining their moral authority when they become too realistic and immersed in social activism. While the Protestant denominations made an honorable contribution to the debates on foreign policy in the 1930s and 1940s, they may unwittingly have laid the foundation for their own decline.

The Disenchantment of the World: A Political History of Religion. BY MARCEL GAUCHET. Princeton: Princeton University Press, 1997, 228 pp. $24.95.

This book seeks to present a comprehensive history of the development of religion and its demise in contemporary society. Unlike Feuerbach and Hegel, Gauchet does not see secularization as a liberation from dogma and alienation. Modern secular man is tied to the future, which he cannot control, just as certainly as any religion tied him to the past. Indeed, Gauchet echoes Nietzsche and Heidegger in arguing that the transition from so-called primitive to "higher" religions during the Axial Age was a degeneration that made later secularization inevitable, and he sees Christianity in particular as an agent of religion's own undoing. While the historical thesis is provocative, the book's present-day normative implications are less than clear.

Anticipating Ethnic Conflict. BY ASHLEY J. TELLIS, THOMAS S. SZAYNA, AND JAMES A. WINNEFELD. Santa Monica: RAND, 1997, 118 pp. $15.00 (paper).

Unlike other recent studies of ethnic strife, this volume is narrowly focused as "a handbook for intelligence analysts to use in thinking about ethnic conflict." Rather than recounting a familiar set of case studies, it provides a matrix of factors that might serve as precursors to ethnic violence, such as the degree of "closure" in the political system, triggering events, state capabilities, etc. While the approach may seem overly mechanistic, the authors provide adequate warning against simplistic misuse of their methodology and put the issue of ethnic conflict in a sophisticated framework of sociopolitical modernization.

Keeping the Peace: Multidimensional U.N. Operations in Cambodia and El Salvador. EDITED BY MICHAEL W. DOYLE, IAN JOHNSTONE, AND ROBERT C. ORR. New York: Cambridge University Press, 1997, 428 pp. $64.95 (paper, $24.95).

This volume distinguishes itself from the many others written recently on U.N. peacekeeping by trading breadth for depth, covering the U.N. Transitional Authority in Cambodia and the U.N. Observer Mission in El Salvador with detailed chapters on all aspects—diplomatic, military, and humanitarian—of their missions. The book concludes that these cases could be considered "qualified successes" because they proceeded, in contrast to Bosnia and Somalia, in situations of preexisting political consent. The Cambodia chapters were, unfortunately, completed before the collapse of the Khmer Rouge and the coup by Hun Sen. The gloomy conclusion is that even relatively favorable initial conditions and massive international investment are often not sufficient to produce a just peace.

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The "Man" Question in International Relations. EDITED BY MARYSIA ZALEWSKI AND JANE PARPART. Boulder: Westview Press, 1997, 219 pp. $59.00 (paper, $18.95).

There is an important book waiting to be written on the subject of gender and international relations, but this volume is unfortunately not it. Over the past generation, a huge body of research, mostly coming out of the natural sciences, has shown the powerful connections that exist between males and violence, aggression, competition in status hierarchies, group identity, and the like—not just for human beings but also for some of our closest primate relatives. Rather than confronting such issues, this book chooses to focus instead on the utterly trivial question of why men dominate the study of international relations. All of the authors begin with the increasingly untenable premise that gender roles are socially constructed. But if masculine "roles" are not merely socially imposed identities but rooted in the genome, the "engendering" of international relations—that is, its feminization—will not be as easy as these writers assume.

Natural Causes: Essays in Ecological Marxism. BY JAMES O'CONNOR. New York: Guilford Press, 1998, 350 pp. $39.95 (paper, $19.95).

Ecological Marxism may seem to be a contradiction in terms, given Marx's commitment to the conquest of nature and the sorry environmental record of real-world socialist societies. This book makes unconvincing suggestions for how to marry the interests of workers and the poor, who need economic growth, and environmentalists, who are opposed to it; it is equally unpersuasive in arguing that the former Soviet Union had better intentions than the West on environmental issues but just somehow got tripped up in the execution.

For a Strong and Democratic United Nations: A South Perspective on U.N. Reform. BY THE SOUTH CENTRE. New York: Zed Books, 1997, 229 pp. $62.50 (paper, $25.00).

This volume, had it been written a generation ago, would have been full of fiery rhetoric about dependency and global injustice and would have put forth a strong program for using the international agency as a mechanism for equalizing rich and poor. As it is, the first two-thirds of the present book are defensive, answering charges by (mostly American) critics of the United Nations regarding excessive staffing, bloated budgets, inefficiency, and the like. The key substantive recommendations are to move security issues from the Security Council to the General Assembly, and to strengthen agencies like the U.N. Conference on Trade and Development and the U.N. Economic and Social Council at the expense of the International Monetary Fund and World Bank, which are seen as agents of Northern interests. While the authors are doubtless right about the latter, the last thing the Third World needs today is a return to the politics of dependency and hostility to the global capitalist order.

Reforming the United Nations: New Initiatives and Past Efforts. EDITED BY JOACHIM MULLER. Boston: Kluwer Law International, 1997, 3 vols., 3,464 pp. $536.00.

This mind-boggling work consists of

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three 1,000-page volumes reprinting every major reform proposal laid out for the United Nations since its inception. A reference work intended for legal experts, it makes no pretense of evaluating or analyzing the different suggestions. The sheer volume of writing on the issue of U.N. reform is testimony to the dysfunctional and perhaps ultimately unreformable character of the organization.

Newsletter. BY THE COMMITTEE ON INTELLECTUAL CORRESPONDENCE. Cambridge: American Academy of Arts and Sciences, Fall/Winter 1997-98, 32 pp.

"There is a paradox in the international cultural world today," write the editors of this slender but important newsletter. Art and architecture are truly global, national cuisines are everywhere, but literature, history, and political and social analysis are more parochial than they have been in decades. Fifty years ago, intellectual conversations begun in Europe would travel to India or America and vice versa. Today, we know very little about the novels and debates of other lands, particularly non-English speaking ones. Two American, two German, and two Japanese scholars have set about to help create an international intellectual conversation—and they succeed admirably. Their newsletter comprises a series of well-written reports on fascinating but often little-known intellectual trends, debates, essays, books, and personalities in America, Europe, and Japan. We learn of French arguments about the avant-garde, the feminist tradition in Japanese literature, and the controversy over Paul Samuelson's classic textbook, *Economics.* One only hopes that the *Newsletter* will broaden its scope to encompass more of Asia and quicken its frequency from a semiannual to a quarterly schedule.

FAREED ZAKARIA

Economic, Social, and Environmental

RICHARD N. COOPER

Big Dragon: China's Future: What It Means for Business, the Economy, and the Global Order. BY DANIEL BURSTEIN AND ARNE J. DE KEIJZER. New York: Simon & Schuster, 1998, 384 pp. $25.00.

The main thesis of this comprehensive, well-informed, well-written, realistic, and, apart from some journalistic hyperbole, largely persuasive book is that China is too large, too self-contained, and too self-absorbed to be much subject to foreign influence. The authors, both business consultants, see many obstacles to economic reform in China's future but believe the country will grow at an implausible 8 percent a year over the next 40 years. The result will be an extensive middle class and lots of personal freedom compared with China's past, but still an authoritarian government wary of corrupting foreign influences that pursues its own conception of China's interests—which, however, does not include military conflict with the United States. But even a successful China will take over two decades to surpass a not-so-successful Japan in economic

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size and at least two decades beyond that to catch up with the much larger United States and European Union (EU). Even then the Chinese will be poor in terms of per capita income by world standards.

China will want a voice in setting international rules, and it will be large enough to influence the international environment, not always in ways comfortable for Americans. The authors urge "dynamic engagement" with China to cultivate strong mutual interests and build a sufficiently sound relationship for Americans to offer constructive criticism to an evolving Chinese society.

Corruption and the Global Economy. EDITED BY KIMBERLY ANN ELLIOTT. Washington: Institute for International Economics, 1997, 244 pp. $20.00 (paper).

Internationalization of business and democratization of many countries have created greater awareness of the corruption endemic to many countries. Wherever people exercise some control, there are likely to be bribes, extortion, and kickbacks, except where strong social and political barriers have been erected against them. This book contains papers presented at a conference on corruption at the Institute for International Economics. Taken together, they address the conceptual or definitional issues—actions considered corrupt in one country may be considered merely facilitating payments in another or necessary campaign contributions in a third—that encourage corruption, its impact on national economic performance, and steps that might be taken to reduce it, at least insofar as it affects foreign trade and investment. There are no definitive answers here, but the book offers a useful review of what is now known about a salient current issue.

European Monetary Unification: Theory, Practice, and Analysis. BY BARRY EICHENGREEN. Cambridge: MIT Press, 1997, 349 pp. $45.00.

A seminal event in 1999 will be the creation of the European Monetary Union with a common currency, the euro. Driven mainly by a political dynamic that is the legacy of two world wars, the EMU will nonetheless have profound economic implications. Eichengreen, a professor at Berkeley, has been one of the small band of American economists who have been attentive students of European monetary integration. This book gathers some of his writing on the EMU over the period 1990-96. He frequently offers valuable comparisons with the United States, research that has helped illuminate how the large U.S. economy copes with diverse shocks to and within its own monetary union. Most of the papers here were written for economists, but the author is clear and cogent in his mode of argument and in arraying empirical evidence. Eichengreen is sympathetic to the objective of a single European currency, but he suggests that Europeans should fasten their seat belts as they move forward.

Immigration in a Changing Economy: California's Experience. BY KEVIN F. MCCARTHY AND GEORGE VERNEZ. Santa Monica: RAND, 1997, 338 pp. $20.00 (paper).

Forbidden Workers: Illegal Chinese Immigrants and American Labor. BY PETER KWONG. New York: New Press, 1997, 273 pp. $24.00.

One-third of foreign-born residents of

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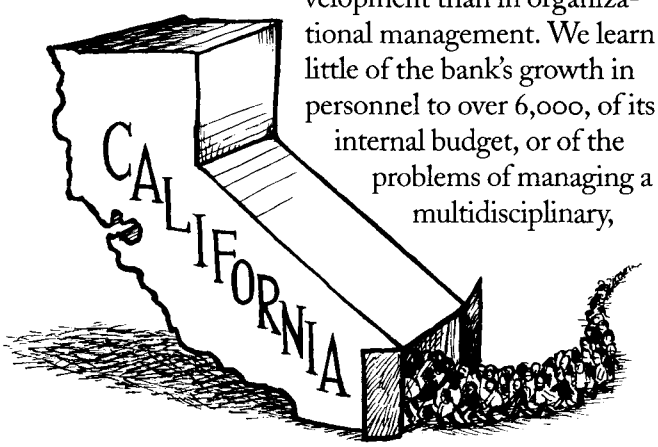
the United States live in California, differing greatly by country of origin but coming disproportionately from Asia and Latin America. The McCarthy-Vernez book is a fact-filled, sober, and sane analysis of California's immigrants, who, compared to other American immigrant populations, have increased in number rapidly in recent decades, have come more frequently from Mexico and Central America, and have had less education. The authors find that immigrants help the state economy on balance but also create some financial burdens. They call for placing less priority on family reunification relative to other objectives. They also advocate more requirements for educational attainment on entry, and more emphasis on both English proficiency and education for resident immigrants and their children, lest they, and California with them, fall behind the rest of the country.

Forbidden Workers provides a fascinating and highly readable account of networks that facilitate illegal emigration from China—mainly from Fuzhou, a city of five million—to New York and elsewhere, and of the lives immigrants encounter. Migration involves incurring large debts to "snakeheads," who arrange for transport and entry and often brutally enforce payment. Because of their illegality and constant pressure from their creditors, Chinese immigrants often accept jobs that pay far less than the U.S. minimum wage and violate American labor standards, and they have no effective legal recourse. The magnitude of the problem, perhaps small but unknown, is likely to grow as the Chinese increasingly seek to improve their prospects by moving out of rural areas.

The World Bank: Its First Half Century. Volume I: History. BY DEVESH KAPUR, JOHN P. LEWIS, AND RICHARD WEBB. Washington: Brookings Institution, 1997, 1,276 pp. $79.95.
Volume II: Perspectives. EDITED BY DEVESH KAPUR ET AL. 766 pp. $79.95.

These massive volumes give a comprehensive rendering of the role of one of the leading and most effective international institutions. Based on numerous interviews and internal bank files and reports but written without bank control, volume one provides an analytical history of the bank since its inception in 1946, with due attention to its role during the debt crises of the 1980s and in trying to stimulate development in the poorest parts of the world. Volume two consists of separately written essays on topics such as project lending in Africa, raising funds in European capital markets, balancing environmental and development considerations, and the sometimes uneasy relations between the World Bank and the U.S. government. The book is suited more for those interested in economic development than in organizational management. We learn little of the bank's growth in personnel to over 6,000, of its internal budget, or of the problems of managing a multidisciplinary,



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multinational organization. There is also little evaluation of the bank's impact on the world economy or even on loan recipients.

Military, Scientific, and Technological

ELIOT A. COHEN

Made to Measure: New Materials for the 21st Century. BY PHILIP BALL. Princeton: Princeton University Press, 1997, 458 pp. $29.95.

Our preoccupation with information technology's forward bounds has obscured no less radical changes in other branches of technology. The cloning of sheep and other marvels of biotechnology have, to be sure, attracted attention to that field, but far less attention has been paid to improvements in material sciences. Here is a book that can serve as a primer. Not written for the technically faint of heart, this book by an associate editor at *Nature* is a dense but accessible introduction to such subjects as photonics, "smart" materials, and nanotechnology. The author does not spell out the consequences for international politics, but with some effort they may be imagined. The replacement of many of the functions of oil as a lubricant and fuel, for example, is far from inconceivable, with consequences for Middle Eastern economics and politics that bear reflection.

Kaigun: Strategy, Tactics, and Technology in the Imperial Japanese Navy, 1887–1941. BY DAVID C. EVANS AND MARK R. PEATTIE. Annapolis: Naval Institute Press, 1997, 661 pp. $49.95.

In the space of one generation Japan created, ex nihilo as it were, a fleet capable of defeating those of two second-rank powers—China and then Russia. Within the space of a second generation it had a fleet that in terms of quality and, in some respects, quantity matched that of the United States or Great Britain. As indicated by the title, this scholarly work deals with the interrelationships of strategy, tactics, and technology. It is not merely a fine historical account but one of more general importance, discussing how choices about weapons reflect martial culture and operational styles. The Japanese bid for qualitative superiority and decisive victory at the first stroke, coupled with ill-understood weaknesses in systems engineering and mass production, created a navy that could inflict severe setbacks upon its American counterpart, but not, ultimately, defeat it. It is rare to find an important work so well illustrated: sketches, tables, charts, diagrams, and pictures serve the authors' purposes brilliantly. Subtle, illuminating, and profound, it is difficult to do justice to a book that will almost certainly hold the field for some decades to come.

Inventing Grand Strategy and Teaching Command: The Classic Works of Alfred Thayer Mahan Reconsidered. BY JON TETSURO SUMIDA. Washington: Woodrow Wilson Center Press, 1997, 164 pp. $24.95.

The connections between the riddles of the Zen masters, the art of concert pianists, and the ruminations of a nineteenth-century American naval captain are not immediately obvious. In this slender, well-wrought volume, however, a prominent student of naval affairs makes them clear. The author has produced a close but

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concise study of the thought of the great historian, publicist, and (Sumida would argue) theorist of the late nineteenth and early twentieth centuries, who remains more revered than read in naval circles. Particularly intriguing are the connections drawn here between artistic activity and the nature of command: Mahan criticized the U.S. Navy's emerging preoccupation with engineering and administration. The executive function in naval affairs had, to his mind, far higher tasks and problems. Whether, as Sumida claims, Mahan invented "historically based and broadly focused international security studies" may be debated, but he makes an interesting case. A fine bibliography and analytical index to Mahan's writings fill out a remarkably compact volume.

Churchill and the Secret Service. BY DAVID STAFFORD. New York: Overlook Press, 1998, 400 pp. $35.00.

Most of the literature on intelligence focuses on those who produce the material rather than those who use it, and the exceptions usually deal with misunderstanding, misuse, and failure in all its forms. This book, however, examines, with an unillusioned but generally admiring eye, a statesman who knew how to read intelligence reports and exploit covert operations. Stafford's Churchill is not the ill-informed and capricious romantic of contemporary debunkers: he is, rather, a calculating, occasionally erring, but immensely shrewd and experienced politician. Nothing very new in the stories recounted here, but they are well told and solidly grounded in archival and secondary sources, and the sum total is original and enlightening.

Korolev: How One Man Masterminded the Soviet Drive to Beat America to the Moon. BY JAMES HARFORD. New York: John Wiley, 1997, 392 pp. $30.00.

A brisk, readable biography of the man behind the Soviet space program by a veteran of the American Institute of Aeronautics and Astronautics. Harford has drawn extensively on interviews and, to a lesser extent, secondary sources, as well as Cold War–era translations of Soviet materials. Sergei Korolev, kept in the shadows by his political masters throughout his life, began his work as a victim of Stalin's purges in a Soviet *sharashka,* or prison camp for scientists. His internment did not prevent him, however, from throwing the whole of his enormous energy and practical skill into the service of the Soviet state. The space race between the United States and the Soviet Union forms the core of the book, and Harford does a fine job of telling just enough about the American side to put Soviet achievements and activities in perspective. Energy, vast resources, and the creativity of Korolev and others like him did much to compensate for the absurdities of Soviet economics, but could only go so far. They beat the United States into space initially but lived to see their rivals beat them to the moon and beyond. A truly scholarly study will, no doubt, emerge in time, but this is a worthy book nonetheless.

Global Communications, International Affairs, and the Media since 1945. BY PHILIP M. TAYLOR. New York: Routledge, 1997, 248 pp. $75.00 (paper, $22.99).

Despite its title, this thoughtful study is

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rather focused: it concentrates on the last two decades and issues of war and peace, rather than, for example, trade and commerce. Taylor demonstrates a good feel for the technology of news gathering and dissemination, the evolution of news organizations, and the political consequences of instantaneous global news. Unlike many recent American writers on this subject, he knows the history of communications well and thus avoids some facile judgments. He stakes out some important claims, as when he dismisses the notion that media coverage played a central role in America's defeat in Vietnam—a view that he regards as a poor excuse for strategic, operational, and tactical errors unrelated to how the war appeared on American television screens. At the same time, he has few kind words for the burgeoning communications industry and the vast majority of the journalists who inhabit it; remarkably enough, he praises the psychological operations community in the American military for its role in some settings.

Nuclear Weapons in a Transformed World: The Challenge of Virtual Nuclear Arsenals. EDITED BY MICHAEL J. MAZARR. New York: St. Martin's Press, 1997, 404 pp. $59.95.

Virtual nuclear arsenals consist of dismantled nuclear weapons, moves toward which form the central theme of this edited work. An impressive array of experts from around the world have contributed essays to the book, not all of them warmly endorsing Mazarr's enthusiasm for a scheme that would leave the current nuclear powers with heaps of bits and pieces in place of missiles and bombers on alert. The obvious problem is that of verification and the danger that a country that might cheat on its rivals and gain a terrifying edge for several weeks as technicians scrambled to rebuild their country's deterrent. One suspects that a world safe for virtual nuclear arsenals will have solved most of its other problems as well.

Cascade of Arms: Managing Conventional Weapons Proliferation. EDITED BY ANDREW J. PIERRE. Washington: Brookings Institution, 1997, 466 pp. $49.95 (paper, $19.95).

Pierre has been writing on this subject for many years, and he has assembled a competent group of coauthors to discuss a variety of subjects, including patterns of arms transfers, the changing economics of the arms market, the policies of suppliers and purchasers, and prospects for arms control. There are some questionable conclusions here (for example, that the former Soviet Union has "collapsed as a major arms supplier"), but the general tone is sober and realistic. The blurring of military and civilian technologies, the spread of coproduction and joint development, and the pressures on shrinking industries for more extensive sales make restraint in arms sales difficult. The editor believes that stringent arms control measures are necessary, in part because of the link between conventional arms and weapons of mass destruction—the possibility that anthrax could end up in the warhead of a cruise missile, for instance. Perhaps, but the record is not very encouraging.

The Soldier-Citizen: The Politics of the Polish Army after Communism. BY ANDREW A. MICHTA. New York: St. Martin's Press, 1997, 139 pp. $49.95.

Of all the challenges of the transition to

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democratic rule in Eastern Europe, one of the more interesting and difficult has been the assertion of democratic models of civilian control. The author contends that subjugation by the Communist Party before 1991 produced powerful impulses to seek autonomy thereafter. On the other hand, in retrospect communism created a military remarkably independent of civilian authority: the idea of a ministry of defense staffed by civilians and headed by someone other than an active duty or retired general, seemed absurd. The post-communist period has been an uneasy one, and in a brief space Michta sums up the tensions that have arisen between the military class and civilians determined to bring them to heel. One concludes that Polish civil-military relations will remain unsettled for some time to come, although the author argues that the main transition to Western patterns of military subordination to civilian control has occurred.

The United States

DAVID C. HENDRICKSON

Liberal Peace, Liberal War: American Politics and International Security. BY JOHN M. OWEN IV. Ithaca: Cornell University Press, 1997, 246 pp. $32.50.

This illuminating work, by a political scientist at the University of Virginia, seeks to explain why liberal states (those with free speech and competitive elections) avoid war with one another but not with illiberal states. Owen sees a symbiotic relationship between these phenomena: "Liberals," he argues, "need illiberals in order to identify one another . . . we need enemies in order to know who our friends are." Owen examines ten war-threatening crises involving the United States from the 1790s to the 1890s, focusing on perceptions of liberality or illiberality among the participants. Oddly, the author says little about the Civil War, although he does note that the war between the states constitutes an exception to the rule that liberal states (as he defines them) do not fight one another. One may go even further: it is the existence of the United States itself (or themselves) that stands in profound tension with the hypothesis of the democratic peace. In 1787, it was the Antifederalists who laid claim to the view that democracies are inherently peaceful and the Federalists who insisted that the American states would fight frequent wars with one another if they lacked a superintending authority to arbitrate their differences.

Keeping the Covenant: American Internationalists and the League of Nations, 1920–1939. BY WARREN F. KUEHL AND LYNNE K. DUNN. Kent: Kent State University Press, 1997, 306 pp. $49.00.

This rewarding study is a continuation of the inquiry launched in Kuehl's *Seeking World Order* (1969). Kuehl died after completing a draft of this study, and we are indebted to Dunn, a historian at Winthrop University, for ably refashioning the manuscript and bringing it to publication. The interwar debate anticipates, in its perplexity, much of the present mood. As the authors note, "acceptance

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of the responsibility to use sanctions lay at the heart of any U.S. commitment to a world community," yet the majority of the internationalists were unwilling to assume that commitment and placed their faith in moral suasion. The nationalists, by contrast, had a keener sense of how the world worked, but failed utterly (unlike the internationalists) to appreciate that instability in Europe could well pose a formidable challenge to American security and well-being. Let us hope the current debate yields a better choice than that posed then: between the universalism and pacifism of the internationalists and the unilateralism and insularity of the nationalists.

The Kennedy Tapes: Inside the White House during the Cuban Missile Crisis. EDITED BY ERNEST R. MAY AND PHILIP D. ZELIKOW. Cambridge: Harvard University Press, 1997, 728 pp. $35.00.

The Dark Side of Camelot. BY SEYMOUR M. HERSH. Boston: Little, Brown, 1997, 498 pp. $26.95.

The Kennedy Tapes, transcripts of recordings made in the White House during the missile crisis of 1962, will be invaluable to historians, even though (perhaps because) they still leave ample room for argument over what brought about the crisis, whether the participants acted wisely, and how it was resolved. The book's conclusion reflects on Soviet motives and asserts that the tapes "subtly but significantly alter our understanding of practically every major question about U.S. policy during the crisis." The alterations, unfortunately, seem far more subtle than significant, and will be detectable, if at all, only to the most inveterate aficionados of this over-studied crisis.

Whereas May and Zelikow see a Kennedy who is calm, lucid, and always a step ahead of his advisers, Hersh writes that in the missile crisis Kennedy for the first time "publicly brought his personal recklessness, and his belief that the normal rules of conduct did not apply to him, to his foreign policy." The indictment rests principally on the absurd assumption that only a personally reckless president would have wished to keep hidden and informal the crisis-resolving offer to remove American missiles from Turkey. The many non sequiturs and strange conclusions in this chapter alone make one suspicious of the veracity of Hersh's enterprising treatment of Kennedy's amazing sex life, although not so suspicious as to avoid venturing the opinion that we at last have found the most convincing explanation for why during the crisis the president should have been so relaxed.

The Unmaking of Americans: How Multiculturalism Has Undermined the Assimilation Ethic. BY JOHN J. MILLER. New York: Free Press, 1998, 320 pp. $25.00.

This work is an important entry in the ongoing and painful debate over immigration and national identity. The author offers "An Americanization Manifesto" that condemns group rights, mandatory bilingual education, and other policies associated with "left-wing multiculturalism," while also affirming (against "right-wing nativists") the centrality of immigration to the American experience and ethos. The excellent opening chapters on "the American idea" are quite moving. Americanization

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programs at the beginning of the twentieth century, Miller argues, were born of a confident and generous faith in the ideals of American life, but they became fatally distorted when the First World War induced rampant fears of division and disloyalty. Compulsive conformity then replaced a healthy and necessary desire for cohesion. Since the author's own program for abolishing group rights is driven (not unreasonably) by the fear of Balkanization, the evident danger is that it pushes too far in the direction of uniformity. But while the author's recommended policies may not all strike the right balance, he presents a strong and convincing case of the balance (between unum and pluribus) that needs to be struck.

Defining the National Interest: Conflict and Change in American Foreign Policy. BY PETER TRUBOWITZ. Chicago: University of Chicago Press, 1998, 353 pp. $55.00 (paper, $18.95).

This intellectually exciting study, by a political scientist at the University of Texas, takes an original look at the influence of sectionalism on American foreign policy. Trubowitz analyzes three decades (the 1890s, 1930s, and 1980s) marked by profound clashes over America's role in the world, and in each case he finds the differing interests of Northeast, South, and West (due mainly to their unequal participation in the world economy) to be decisive in determining the outlook of political leaders. Along the way he wages an intrepid fight against realist explanations that emphasize external forces, cultural explanations that emphasize political ideology, and institutional explanations that emphasize the structure of the state in their respective accounts of conflict and change. Whether so much explanatory punch can be provided by sectional interests defined almost entirely in material terms will undoubtedly be questioned. But the freshness of view and vigor of analysis displayed in this work entitle it to wide attention.

After the Cold War: American Foreign Policy, Europe, and Asia. BY ARTHUR I. CYR. New York: New York University Press, 1997, 204 pp. $40.00.

A sober and wide-ranging analytical essay placing American foreign policy and the evolution of the international system in a broad historical context. Cyr, who is president of the World Trade Center and former Vice President of the Chicago Council on Foreign Relations, explores the intellectual, structural, and sociological dimensions of U.S. policy, usefully characterizing the challenge for America after the Cold War as one of "leadership in a non-crisis environment." He places particular emphasis, somewhat idiosyncratically, on the special role that Great Britain and South Korea should play in U.S. policies. Although the work lacks any startling new perspectives, the author does give thoughtful consideration to the ways in which the United States should use "traditional diplomacy, economic persuasion, military means and political example to lead in ordering a more stable world."

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Western Europe

STANLEY HOFFMANN

Tamed Power: Germany in Europe. EDITED BY PETER J. KATZENSTEIN. Ithaca: Cornell University Press, 1997, 314 pp. $49.95 (paper, $19.95).

This study of the relations between Germany and a unifying Europe is important both for its contribution to the endless theoretical debate about European integration—whether it is driven by governmental bargains or by a logic of "spillover" that constrains and reduces the sovereignty of the member states—and its analysis of Germany's relations with (mainly) the smaller states of Western and Eastern Europe. Katzenstein's introductory chapter emphasizes the ways in which institutions shape not just the interests but the identities of the participants. Because Germany has chosen to exert not hard but soft power—influence and persuasion—through the institutions of the EU, "German domination over contemporary Europe is a mirage." German material power is not a threat, but there is a "'creeping German colouring' of European institutions." The other chapters analyze the way in which Germany has used its "soft power" in a variety of policy realms and the changes since Germany's unification.

A Berlin Republic: Writings on Germany. BY JÜRGEN HABERMAS. Lincoln: University of Nebraska Press, 1997, 187 pp. $40.00 (paper, $14.95).

Political philosophers spend more time building cathedrals of theory than commenting on policy issues. How refreshing to find that Habermas, whose "discourse theory" of rational deliberation in an open public sphere can be awesomely abstract, is also a subtle, wise, and effective public intellectual. In this slim collection of addresses, interviews, and articles written after the great divide of 1989, he insists on "de-stasification" in the East as essential for the production of a liberal political culture, and he rejects the tendency to look at both West and East Germany before 1989 as intellectual and political satellites of their respective superpowers. Equally impressive is his conviction that "a liberal political culture could develop in a culturally highly civilized society such as Germany" not only after Auschwitz but "because of Auschwitz, because of reflections on the incomprehensible." He also pleads for "equal opportunity to exercise formal equal rights," which leads him to support quotas and hiring preferences, asserts the universality of human rights, which entails a defense of the right of asylum, views the nation-state as the source of political legitimacy and the locus of cultural identity, yet also as both dangerous (because of nationalism) and increasingly obsolete, and pleads to Europeans "for halting within their own societies the decline of existing social standards."

French Peasant Fascism: Henry Dorgères's Greenshirts and the Crises of French Agriculture, 1929–1939. BY ROBERT O. PAXTON. New York: Oxford University Press, 1997, 244 pp. $45.00 (paper, $19.95).

Once again, Robert Paxton has done pioneering work. His book on the

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Vichy regime, very controversial in France at first, is now a classic on both sides of the Atlantic. The first to document the extent of Vichy's collaboration with the Nazis, he is now the first—despite formidable difficulties in finding adequate sources—to produce a book-length study of a militant anti-republican, authoritarian, and corporatist peasant movement that made a great deal of trouble for the weak cabinets of the Third Republic between 1929 and 1939. Its leader, Henri Dorgères, was a journalist for a farmers' newspaper in Brittany. His "greenshirts" were especially abundant and vocal in northern and western France, where French peasants were more conservative than in the south. Their desire to rehabilitate, and to restore the preeminence of, the French peasantry was kindled by the steep agricultural recession in the 1930s and their dislike of the paralyzed parliamentary republic as well as of the established peasants' organizations that were run by notables close to the politicians.

As Paxton points out, Dorgères' methods were borrowed from the fascists abroad, but his program, which was anything but statist, was closer to the authoritarian conceptions of a Salazar or Franco. Dorgères should have played a major role in Vichy, given his views and Vichy's establishment of a Peasant Corporation replacing all previous associations. But he was relegated to minor propaganda functions—just enough to get him jailed by the victorious Resistance. Elected to the National Assembly in 1956, thanks to a new wave of rural protest led by Pierre Poujade, he lost his seat when de Gaulle returned to power. He died, at 88, in 1985. Paxton's book provides us with a fine analysis of Dorgères' tactics, of his relations with his rivals and with the state, and of the reasons why, even before the extraordinary transformation of French agriculture after the Second World War, Dorgères never succeeded in capturing the bulk of the peasantry.

The Long Presidency: France in the Mitterrand Years, 1981–1995. BY JULIUS W. FRIEND. Boulder: Westview Press, 1998, 308 pp. $40.00.

A long-time analyst of French politics, Friend has written a well-informed overview of the French domestic and external policy scene during the two terms of Mitterrand's presidency. The emphasis is on the second term, the first having been covered in more detail in an earlier book by Friend; it is also on narrative more than analysis. But the tale is very ably told, and the narrator has a firm grasp not only of the complexities and detours of French affairs but also of the personalities whose rivalries provided the story with most of its substance—in an era when governments of the left as well as the right discovered how little freedom of maneuver they had in economic and social affairs. The portrait he draws is that of a devious, vindictive, manipulative tactician whose flaws were partly redeemed by charm, culture, and personal courage. The record of achievement is short, and his place in history, as Friend points

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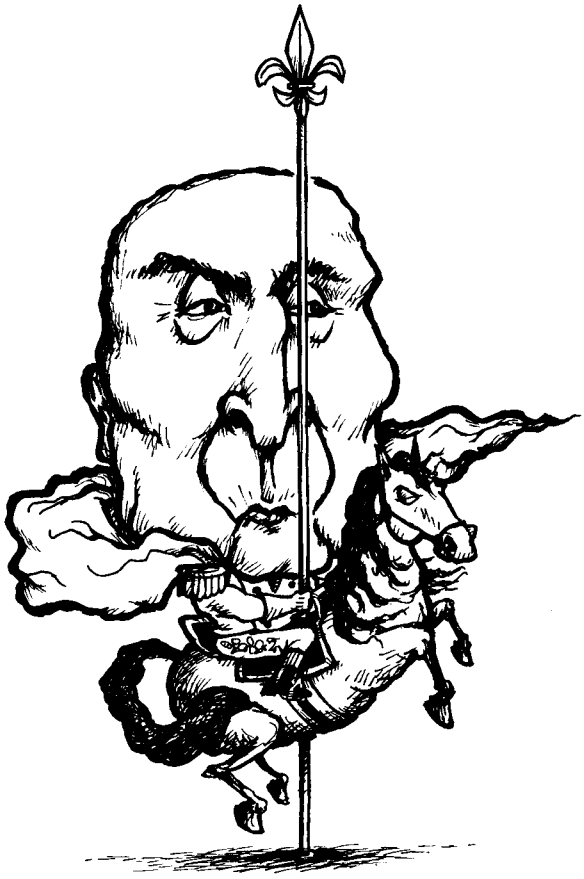
out, will depend on the fate of the EU, his only long-range design.

The Hitler of History. BY JOHN LUKACS. New York: Alfred A. Knopf, 1997, 279 pp. $26.00.

This thought-provoking, probing, and often provocative book is not a biography but a discussion of biographies and memoirs and an attempt to address many of the mysteries or questions about Hitler. Lukacs shows that he was both reactionary and revolutionary—a revolutionary populist, moved by hatred, in a democratic age. He states that Hitler was much more a nationalist than a racist and produces some startling quotations asserting that "there is no such thing as the Jewish race," and that "the German Volk contained several races." His chapter on the Jews, however, adds little to the huge literature. Lukacs deems Hitler's qualities as a statesman insufficiently studied and offers a defense of many of Hitler's strategic decisions in World War II, when, he believes, Hitler adopted a "Frederician" strategy—that is, inspired by Frederick the Great, and focused on winning by defeating one of the main enemy's powers. This leaves out some of the irrational policies that contributed to Germany's defeat, such as the treatment of the populations of occupied Ukraine. As for the Germans, he emphasizes their support of and affection for Hitler, if not for the Nazis.



Franco's Spain. BY JEAN GRUGEL AND TIM REES. London: Arnold, 1997, 206 pp. $19.95 (paper).

This crisp, masterly volume, written by Grugel, a political scientist, and Rees, a historian, provides a clear and convincing account of the Franco regime. The harsh triumph of the conservative reaction against the short-lived republic, after a dreadful civil war, and under the leadership of the military and the clergy, was followed by a kind of permanent balancing game among the different interests and conceptions represented in this coalition. Franco was a skillful juggler who moved this mix away from the fascism of the Falange toward a more Catholic, conservative, and authoritarian formula. But the regime depended on Franco for its survival and fell apart once the bureaucratic class turned to democratization. The economic and social transformation of the 1960s and 1970s produced an industrializing society with inadequate welfare services,

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industrial unrest, and corruption that the Francoist state could not contain or control. However, the transition to democracy, according to the authors, has been made more difficult by the legacy of authoritarianism.

European Integration in Social and Historical Perspective: 1850 to the Present. EDITED BY JYTTE KLAUSEN AND LOUISE A. TILLY. Lanham: Rowman & Littlefield, 1997, 323 pp. $64.00 (paper, $22.95).

The authors provide lucid perspectives often lacking in books on the travails of the EU. First, they are informed by a sense of history. Carl Strikwenda reminds us of the considerable integration achieved since World War I and the extent to which economic integration has depended on politics and peace. Christiane Lemke, Gérard Noiriel, and Michel Offerlé show how the modern German and French states constructed their national concepts of citizenship, and Leslie Page Moch looks at foreign workers in pre–European Community Europe. Second, the authors examine the interplay between social groups, their representative institutions, and those of the state. They discuss industrial relations, the rise of the welfare state, and relations between markets and states in Eastern and Western Europe, along with migrant workers in present-day Europe and the struggle for women's rights. A short afterword by Eric J. Hobsbawm notes that European integration has been patchy, unsuccessful in defining a European identity, institutionally complicated, and geographically incomplete.

Western Hemisphere

KENNETH MAXWELL

Panama's Canal: What Happens When the United States Gives a Small Country What It Wants. BY MARK FALCOFF. Washington: AEI Press, 1998, 162 pp. $29.95 (paper, $14.95).

Falcoff, a resident scholar at the American Enterprise Institute, deploys to excellent effect his formidable literary and polemical skills and does not hesitate to use unflattering adjectives to dispel political obfuscation. He describes in considerable detail the large tasks Panama will face over the two years remaining before the Panama Canal passes into its ownership under the 1977 treaties, including replacing the income from U.S. bases with well-paying jobs, disposing of billions of dollars worth of property in an orderly manner, reversing the negative ecological trends in the Chagres River basin, and maintaining the canal at peak efficiency while setting aside large sums for capital improvements—as well as retaining the confidence of foreign investors and addressing economic reform and privatization. But the central concern is how well Panama will be able to live "without the United States as a stopgap and a scapegoat" and to dampen popular expectations that the "reverted areas" will be a piñata of patronage.

Pleasure Island: Tourism and Temptation in Cuba. BY ROSALIE SCHWARTZ. Lincoln: University of Nebraska Press, 1997, 239 pp. $45.00.

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Waiting for Fidel. BY CHRISTOPHER HUNT. Boston: Houghton Mifflin, 1998, 259 pp. $13.00 (paper).

Inside the Revolution: Everyday Life in Socialist Cuba. BY MONA ROSENDAHL. Ithaca: Cornell University Press, 1997, 197 pp. $37.50 (paper, $14.95).

As Schwartz clearly demonstrates in her fascinating account of Cuba's tourist industry from the 1920s to Castro's takeover in 1959, tourism brings with it speculation, entrepreneurship, and corruption. Prostitution rackets are again providing members of the military and security establishment with extra off-the-book incomes. Schwartz is not surprised to see the Castro regime confronting in the 1990s some of the same dilemmas and temptations that tourism caused Castro's predecessor Fulgencio Batista in the 1950s.

A wry, hyped-up, and amusing insight to this curious new Cuba is provided in Christopher Hunt's travel account. This tale recounts his picaresque adventures in Cuba "from Havana's squalid alleys to its steamy nightclubs. From Cuba's endless expanses of sugar cane to the craggy peaks that once sheltered the bearded dictator." Hunt, a former reporter for *The Economist*, believes most Cubans have given up on socialism and turned to capitalism Cuban-style, with a thriving black market where sex is a major currency and hustlers and hacks rule the roost. Heady stuff this, but it is a nice change of tone from the gloomy statistics of the Cuba experts.

Away from the big city, however, the picture seems less cynical and Castro's ethos more permanent. Rosendahl, a Swedish anthropologist, has written a rare close-up analysis of how the ideology of the Cuban revolution translates itself into everyday experience. Her study of a municipality in Oriente province provides a nuanced antidote to those who would argue that the regime no longer enjoys grassroots support. Despite the hardships that have befallen all Cubans following the collapse of the Soviet Union, Rosendahl sees a more pragmatic discourse among both leaders and people. She also argues that the 1996 Helms-Burton Act only served to solidify the link between anti-American patriotism and the deterioration Cubans see around them in the real health and social benefits the revolution has achieved.

Politics of Illusion: The Bay of Pigs Invasion Reexamined. EDITED BY JAMES G. BLIGHT AND PETER KORNBLUH. Boulder: Lynne Rienner, 1998, 284 pp. $49.95.

Bay of Pigs Declassified: The Top Secret Report of the CIA Inspector General on the Invasion of Cuba. EDITED BY PETER KORNBLUH. New York: New Press, 1998, 288 pp. $17.95 (paper).

The volume edited by Blight, of Brown University's Watson Institute for International Studies, and Kornbluh, a senior analyst at the National Security Archive, provides the transcripts of an extraordinary discussion between many of the key participants in the tragic Bay of Pigs invasion. What is most striking from this fascinating retrospective is the extent to which illusion permeated the thinking of all parties to the plan, and the conclusion that delusion rather than betrayal was the fundamental cause of the disaster. The participants now believe that the fiasco decapitated the growing and widespread opposition to Castro within Cuba itself, and the recourse to an ill-planned intervention only accelerated and provided justification for more repression.

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The devastating inside review carried out by the CIA's own inspector general, Lyman Kirkpatrick, in 1961—describing bungling and miscommunication at all levels—can be obtained in the forthcoming *Bay of Pigs Declassified.* The report, one of the most closely held secret documents of the Cold War and the CIA, was vigorously challenged at the time by the CIA deputy director for planning, Richard Bissell, and his response as well as Kirkpatrick's stringent criticism are sobering reading even 37 years after the event.

The Fall of Che Guevara: A Story of Soldiers, Spies, and Diplomats. BY HENRY BUTTERFIELD RYAN. New York: Oxford University Press, 1998, 224 pp. $27.50.

In this well-written and exhaustively researched book, based in part on new information obtained under the Freedom of Information Act and extensive interviews, a retired Foreign Service officer examines the U.S. response to Che Guevara's insurgency in Bolivia. Ryan places his story within the context of the chapter in U.S. foreign relations that opened with the failed Bay of Pigs invasion and saw, over the six-year period leading up to Guevara's capture in 1967, a dramatic improvement of U.S. counterinsurgency capability. The government's success in defeating Guevara, he argues, ended Havana's efforts to spark a revolutionary uprising in the Western Hemisphere. Ryan contends that Douglas Henderson, the U.S. ambassador to Bolivia, and Ralph Shelton, who headed the Green Beret detachment sent to train the Bolivian army, exercised considerable restraint, preventing the Americanization of the struggle and leaving Guevara, who lacked a good rapport with the local population, isolated and exposed.

Twilight on the Line: Underworlds and Politics at the U.S.-Mexico Border. BY SEBASTIAN ROTELLA. New York: W. W. Norton, 1998, 320 pp. $25.00.

A magnificent story of the chaotic life along the 14-mile U.S.-Mexican border between San Diego and Tijuana. Rotella covered the U.S.-Mexican border from 1991 to 1996 for the *Los Angeles Times,* where he is now Latin America bureau chief. He has created a rich and detailed tableau against which he portrays the simultaneous process of democratization and violence within Mexico and a locale where the best and the worst of U.S. and Mexican societies collide and blend. He gives an intimate picture of drug kingpins, both corrupt and courageous policemen, young immigrant boys high on octane booster selling their bodies in Balboa Park, and trans-border street gang members caught up in high Mexican politics. Rotella sees the contradictions of Mexico reaching a breaking point in the 1990s along this tumultuous no man's land.

Eastern Europe and Former Soviet Republics

ROBERT LEGVOLD

Chechnya: Tombstone of Russian Power. BY ANATOL LIEVEN. New Haven: Yale University Press, 1998, 430 pp. $35.00.

For most of the world, including most

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Russians, the war in Chechnya was a loud rumble, but where it came from and what it represented remain something of a mystery. Lieven gives the war a precise, detailed, and compelling profile. From 1990 to 1996 he was the London *Times* correspondent in Moscow, and there the war became his beat. He covered it not merely from his office but during many trips to the region, and not simply to the ill-fated capital of Grozny but into the hills and amid the mundane brutality. Before Yeltsin made his tragic decision to intervene at the end of 1994, Lieven had been visiting the region for more than two years, so he knew well—and reports well on—the players and gambits going back to 1991. Lieven is a remarkably talented writer and a fine historian. As a result he provides much more than an eyewitness account of the war's smells, colors, and pain; he relates the conflict to Russia's own uncertain battle with itself, explaining the mix of politics and miscalculation that led its leadership to make this mistake, what the conduct of the fighting tells us about the state of the country, particularly key institutions like the military, and why, in the end, it lost. One is hard-pressed to say whether the Russian or the foreigner will gain more from this book.

Settling Accounts: Violence, Justice, and Accountability in Postsocialist Europe. BY JOHN BORNEMAN. Princeton: Princeton University Press, 1997, 197 pp. $49.50 (paper, $14.95).

Borneman, an anthropologist, wrestles with a troubling question: should a society adjudicate the sins of the fathers if they are authority figures from a prior regime that operated outside the rule of law? Yes, he answers—if the society is democratic, or wishes to be and cares about the roots of its legitimacy, or if it wants to avoid cycles of revenge and retaliation. As Borneman notes, from Argentina to South Korea, people are struggling with the proper response to past abuse. But nowhere does the issue lurk so large as in the formerly communist states. In most instances, these societies, by whatever confluence of device and indifference, have chosen to let sleeping dogs lie. A few have not, and Borneman makes a complex philosophical and practical argument for why they are likely to be better off. A reunified Germany provides his central case and a detailed illustration of who has been tried and for what. A reader willing to forgive him such words as "essentialize" and "sacrality" will be rewarded with a subtle, albeit hardly indisputable, notion of "retributive justice" and its value.

A History of Twentieth-Century Russia. BY ROBERT SERVICE. Cambridge: Harvard University Press, 1998, 688 pp. $29.95.

Another addition to the swelling cluster of general histories of Russia before and after the 1917 revolution that have been published since the fall of the Soviet Union. Service deals with the three Russias of the twentieth century: the czarist regime in its last, failing years, the Soviet Union, and the young Russia of the moment. For the uninitiated, he offers a compact, well-rounded account of each regime's salient features, permitting the reader to think about them in the context of the others. The more experienced reader may wish for a bolder set of interpretive themes by which to squeeze greater meaning from this remarkable story, something clearer and deeper than

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the potpourri of competing views that he lays out in the introduction and largely abandons for the rest of the book.

Russia: A History. EDITED BY GREGORY L. FREEZE. New York: Oxford University Press, 1997, 478 pp. $45.00.
A team of 13 historians write the history of Russia from its beginnings in 1450 up through 1995. Each chapter discusses a period; each author is a specialist on that era. Treating whole centuries in 30 pages means the account frequently lacks depth, although, given the expertise of the authors, not insight. Often, however, not even insight is possible when, for example, foreign policy for the period from Joseph Stalin's death to Mikhail Gorbachev's arrival is handled in three short paragraphs. A great many important subjects get thus dispatched. Inevitably coherence of theme is sacrificed to the richness of multiple expertise. The intended audience would appear to be college students and the general reader looking for a basic reference source; both will appreciate the handsome photos, prints, and posters that appear throughout.

The Political Economy of Russian Regional Governance. BY KATHRYN STONER-WEISS. Princeton: Princeton University Press, 1997, 240 pp. $35.00.
Focused on regional government, this is one of the first studies of whether and why government is working in Russia. Stoner-Weiss sets up a series of criteria for effectiveness—trade and economic performance, modernization, and educational improvement—as well as for government "responsiveness"—constituent satisfaction. She then compares the results among four regional governments. Nizhny Novgorod, the region of the young former first deputy prime minister, Boris Nemtsov, and Tyumen, the great oil-producing region, perform best; Yaroslavl and Saratov, less well. Why? Not, she argues, because the more successful regions were more democratic, reform minded, or blessed with skilled leadership. These advantages, to the extent they existed, were less the cause than the result of governmental effectiveness. Rather, regions favored by highly concentrated economic power in a few giant enterprises excelled because business leaders and politicians found it easier and more rewarding to collaborate. Democratic theorists may not take much satisfaction from her results; political scientists, however, will be stimulated by her elaborate use of fashionable theory, an aspect other readers may more readily endure than enjoy.

The Time of the Gypsies. BY MICHAEL STEWART. Boulder: Westview Press, 1997, 302 pp. $28.00.
Nearly every poll taken in Eastern Europe shows Gypsies to be the most mistrusted, even loathed, members of society, no matter the country. The Nazis exterminated 500,000 Gypsies in an attempt to "eliminate their 'degenerate' and 'antisocial' way"; the communists attempted to assimilate them for largely the same reason. Today Gypsies face routine but increasing brutality from ordinary citizens. Constituting roughly five percent of the population in Eastern Europe, rather than the tiny fraction they account for in Western Europe, they are a consequential social

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group. Beginning in 1984, Stewart, an anthropologist trained at the London School of Economics, lived among Hungarian Vlach Gypsies for 15 months. As Stewart's mentor, Maurice Bloch, writes in the foreword, at one level this is "a study of how some of the most marginal and exploited people that exist can imagine themselves to be princes of the world." So is it a special angle from which to view the biases of mainstream Hungarian society.

Middle East

L. CARL BROWN

The Future of Iraq. EDITED BY JOHN CALABRESE. Washington: Middle East Institute, 1997, 140 pp. $5.00 (paper).

Books on Iraq must ever be behind the times, but such is the systemic stability of the confrontation with Saddam Hussein's government that this slim volume is not outdated. Nine authors handle the usual subjects, including the impact of sanctions, oil and general economic prospects, and Iraq's regional policies in the 1990s, plus they give descriptions of Iraqi political culture with an eye to what the future might hold. As for U.S. policy recommendations, Paul Wolfowitz prefers getting rid of the Iraqi regime using not just military pressure but "a political strategy that makes clear not only our opposition to Saddam, but also our willingness to support an alternative." One would have thought that was already quite clear. Abbas Mehdi scores U.S. covert action for having relied on "coup-makers rather than nation-state builders," but his alternative, including a "positive, rather than a punitive, approach" to Iraq, implementation of human rights, and indicting Saddam Hussein for war crimes, seems more a wish list than a policy. Madeleine Albright's March 1997 speech indicating no change in U.S. policy toward sanctions without a regime change in Iraq is included. This stance bears watching now over a year later. Giandomenico Picco offers the bold speculation that given Israel's "strategy of demonizing Iran" and the need to balance Syria an Israeli-Iraqi rapprochement might emerge.

The Decline of the Arab-Israeli Conflict: Middle East Politics and the Quest for Regional Order. BY AVRAHAM SELA. Albany: State University of New York Press, 1998, 423 pp. $24.95 (paper).

Sela traces from the 1950s to the present what he sees as the emerging dominance of individual Arab state interests over pan-Arabism. Since calls for supporting the Palestinians against Israel can rally Arab peoples and intimidate reluctant Arab governments, the decline of state-transcending Arabism has made it easier to treat Israel as a "normal" state and regard the Palestinians as moving toward statehood in a multistate system. The heyday of Arabism was in the Nasserist 1950s, and the great turning point was the June 1967 war. Such later milestones as the October 1973 war, the 1982 Israeli invasion of Lebanon, the long Iraq-Iran War, and the Gulf War all nudged the region toward the Westphalian model of competing states. Readers may question Sela's argument. Has the appeal of Arabism (or its Islamist variant) declined all that much? Haven't Arab states always called the shots? Is Arab acceptance of Israel assured? Still, they must be im-

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pressed by his richly documented narrative of inter-Arab diplomacy, which is fair to all parties.

Islam, Democracy, and the State in North Africa. EDITED BY JOHN P. ENTELIS. Bloomington: Indiana University Press, 1997, 228 pp. $35.00 (paper, $15.95).

Fielding a veteran team of American Maghribi specialists, this book discusses Islam and politics, human rights, aspects of political economy, and the international dimension of prospects for democratization in Islamic North African states. The Islam chapters, for all their different orientations, fit into the following formula: Islam is misunderstood and often demonized in the West, the role of governments in the area in confronting Islamism has been ham-fisted at best, and there are numbers of Islamist moderates with whom these Maghribi governments and the West could work. The political economy chapters paint a bleak picture of high unemployment, statist regimes uncomfortable with privatization, and rentier governments receiving just enough outside support to avoid the tough choices required to accommodate their domestic constituencies. All chapters advance useful arguments based on solid research. Mark Tessler's richly documented thesis that support for Islamist movements is closely correlated to lack of economic opportunity is particularly noteworthy.

Economic Challenges Facing Middle Eastern and North African Countries: Alternative Futures. EDITED BY NEMAT SHAFIK. New York: St. Martin's Press, 1998, 266 pp. $68.00.

Prospects for Middle Eastern and North African Economies: From Boom to Bust and Back? EDITED BY NEMAT SHAFIK. New York: St. Martin's Press, 1998, 325 pp. $68.00.

These two volumes produced under the aegis of the Economic Research Forum for the Arab Countries, Iran, and Turkey primarily bring together papers presented at a workshop in Tunisia in June 1995. The second volume bears a marked World Bank stamp, with 19 of the 22 contributors coming from that organization. It treats issues that go beyond single countries (for example, the region's relations to the emerging world economy, poverty, and environmentally sustainable growth). The first volume has 12 chapters on individual countries (excepting one chapter treating the Gulf Cooperation Council states). All these chapters are written by specialists who are either working in the country they study (the majority) or have roots in that country—and are free of Orientalism. With a helpful synopsis introducing each chapter, these two well-integrated books offer quality studies illuminated by statistics, charts, and graphs as well as useful bibliographies. Solid reference works. Bankers' prices.

The Ottoman Gulf: The Creation of Kuwait, Saudi Arabia, and Qatar. BY FREDERICK F. ANSCOMBE. New York: Columbia University Press, 1997, 270 pp. $47.50 (paper, $17.50).

Anscombe traces the Ottoman Empire's last big effort to strengthen its position in

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Arabia, beginning in the 1870s and ending in failure by 1913. Most accounts of Arabia in these years have told the story from the perspective of the British, the Saudis, or the Hashimites. But there was another party—the Ottoman Empire, which just happened to claim sovereignty over most of the area. Anscombe presents the Ottoman role and perspective while giving due attention to the activities of the outside powers (essentially Britain) and the Arabs. Starting with the earlier Ottoman role in the Gulf, the book then describes Prime Minister Midhat Pasha's bold plan to reassert Ottoman control and mount an ambitious economic development program. Later chapters follow events to the (unratified) 1913 Anglo-Ottoman accord recognizing Britain's position in Kuwait. Why the Ottoman failure? Imperial overstretch with too many problems in too many places, and rudimentary transportation that made Arabia very far from Istanbul.

Asia and the Pacific

DONALD ZAGORIA

Disarming Strangers: Nuclear Diplomacy with North Korea. BY LEON V. SIGAL. Princeton: Princeton University Press, 1998, 321 pp. $29.95.

Written by an academic political scientist and former editorial writer for *The New York Times,* this is a sobering tale describing how close the United States came to war with North Korea in 1994 before Jimmy Carter's visit to Pyongyang broke the ice and laid the groundwork for Assistant Secretary of State Robert Gallucci's extraordinary diplomatic work. The book explores the series of intelligence and policy failures that prevented the U.S. government from comprehending that North Korea was seeking accommodation as early as 1991. Most senior Bush administration officials incorrectly believed that nuclear diplomacy with North Korea could not succeed, and hostility in Congress to dealing with North Korea reinforced their reluctance to try. The Clinton administration compounded these failures by initially embracing ends that could not be attained and eschewing deal-making. Finally, the administration had what one State Department official called a "gaping void at the top of the bureaucracy": there was no one in charge of policy toward North Korea. As a result, American diplomatic strategy was one of drift punctuated by spasms of zigzagging. This failure highlights a critical weakness: the inability of the United States to develop a balance of carrots and sticks for adversaries who are extremely unpopular domestically, who are easily demonized, and with whom it has no diplomatic relations. One shortcoming of the book is that it completely overlooks the difficulties of dealing with Pyongyang, an isolated, totalitarian, and paranoid Stalinist regime whose messages were easy to misread.

China's Transition. BY ANDREW J. NATHAN. New York: Columbia University Press, 1997, 313 pp. $27.50.

The author has an easy time dismissing those who argue that China is not culturally capable of democracy. Taiwan demonstrates the fallacy of such a contention. And he also convincingly argues that the Chinese legacy of authoritarian rule does not bar a democratic transition.

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Indeed, if that were the case, few countries would ever have made the transition. He is also correct to warn that without an institutionalized rule of law, China could become a twentieth-century version of Bismarckian Germany or Meiji Japan. Unfortunately, in this collection of essays, Nathan does not test his own ideas against the impressive body of theory on democratization associated with such scholars as Henry Rowen, Samuel Huntington, Guillermo O'Donnell, and Juan Linz. Rowen has demonstrated that a per capita income of $8,000 or more is highly correlated with democracy. And where there are exceptions, such as the Persian Gulf emirates or Singapore, the absence of democracy can be explained by a paternalistic authoritarian elite. Both in Taiwan and South Korea, the two Asian countries that have recently made a transition to democracy, the key factors were leaders who were more prepared to have free elections and much higher levels of per capita income than are now present in China.

Japan, Internationalism, and the U.N. BY RONALD DORE. New York: Routledge, 1997, 192 pp. $75.00 (paper, $24.99).

This is a thoughtful argument by a noted British specialist on Japan who wants the country to stop being a "reactive" state concerned about equality with the United States and to take more initiatives on behalf of strengthening world order. His specific recommendation is that Japan should become the champion of the United Nations and give priority in its foreign policy to the objectives of strengthening the U.N. security system and the international rule of law. There is much to be said for a number of the author's propositions—especially that Japan needs to take a more proactive stance in world affairs. But the book is flawed by an excessive faith in the United Nations and an equally excessive suspicion of the United States. He seems to believe that the principal task facing the world is the taming of American power rather than of the most ruthless members of the international system.

Shared Hopes, Separate Fears: Fifty Years of U.S.-Indonesian Relations. BY PAUL F. GARDNER. Boulder: Westview Press, 1997, 318 pp. $75.00 (paper, $21.95).

Though it is the fourth-most populous country in the world and has great strategic significance, there is a profound ignorance about Indonesia in the United States. A respected diplomat with long experience in Indonesia, Gardner has written a comprehensive account of U.S.-Indonesian relations since the birth of the Republic of Indonesia in 1945. He draws on official U.S. documents and the recollections of key actors on both sides. What makes this volume stand out is not only that the author has the good diplomat's sense of history but the good journalist's instinct for the colorful quotation. He brings the half-century of U.S.-Indonesian relations to life by recounting the firsthand impressions of diplomats, military men, and political leaders who participated in the events. The result is a balanced historical account and a good read.

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Useful Adversaries: Grand Strategy, Domestic Mobilization, and Sino-American Conflict, 1947-1958. BY THOMAS J. CHRISTENSEN. Princeton: Princeton University Press, 1996, 319 pp. $49.50 (paper, $19.95).

The author, a young China scholar, makes a convincing and original argument that political leaders, in order to secure public support for their fundamental grand strategy, may have to adopt a more hostile foreign policy than they would prefer. He examines the case of American policy toward China from 1947 to 1958 and argues that Truman could have mobilized the American public for the global competition with the Soviet Union only by developing a consistently anticommunist strategy for Europe and Asia. Given the strength of the domestic pro-Kuomintang lobby, in order to rally support for the Marshall Plan, NATO, and significant increases in the defense budget, Truman could not have taken the softer line toward communist China that some of his advisers preferred and that might have averted the Korean War. The volume is indispensable for anyone interested in Sino-American relations.

Africa

GAIL M. GERHART

Learning from Somalia: The Lessons of Armed Humanitarian Intervention. EDITED BY WALTER CLARKE AND JEFFREY HERBST. Boulder: Westview Press, 1997, 276 pp. $65.00 (paper, $19.95).

Mending Rips in the Sky: Options for Somali Communities in the 21st Century. EDITED BY HUSSEIN M. ADAM AND RICHARD FORD. Lawrenceville: Red Sea Press, 1997, 673 pp. $89.95 (paper, $24.95).

The Clarke-Herbst book presents analyses by foreign experts, most of whom were directly involved in U.S. or U.N. operations in Somalia in 1993-94. Several contributors dismiss the conventional view that Operation Restore Hope succeeded but the U.N. Operation in Somalia, the follow-up to ensure peace during Somali reconstruction, failed due to U.N. bungling. They argue that since the United States drove both interventions, it cannot escape all blame for the United Nations' largely predictable inability to solve Somalia's political problems. One lesson, say the editors, is that humanitarian interventions in failed states are too complicated to be conducted as surgical strikes. Another is that if the United States wants the United Nations to succeed in complex peacekeeping situations, it must greatly increase its commitment to strengthening the world body.

The Adam-Ford book is a compendium of 40 chapters, over half by Somali authors, addressed to charting a way forward. Key topics include the relative success of northerners in constituting the as yet unrecognized Somaliland, the rebuilding of legislative and law enforcement processes, and the development roles of women and indigenous nongovernmental organizations. To the extent that any consensus emerges, it is that although international support is vital, rebuilding Somalia can only be directed by Somalis because they alone can re-stitch the intricate fabric of their unique culture and society.

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Angola: Struggle for Peace and Reconstruction. BY INGE TVEDTEN. Boulder: Westview Press, 1997, 166 pp. $59.00 (paper, $21.00).

This concise but solid new volume in Westview's series of African country studies offers an overview of Angolan history, politics, society, and economics. Angola was a victim both of the Cold War and the Cold War's end, first as a strategically located host to a superpower proxy war, then as sharply devalued goods abandoned by both rival suitors. Add the unquenchable personal ambitions of rebel leader Jonas Savimbi and the ineptitude bequeathed to the post-independence regime in Luanda by centuries of Portuguese misrule, and the outcome was hardly surprising: a country devastated by war, social dislocation, poverty, and mismanagement. Angola's abundance of natural resources, the author argues, ought to guarantee its future recovery, but not unless the country's fractious parties work out a political settlement and make it stick. Neither the United States nor the United Nations can be proud of its record, but it is not too late for constructive input, particularly in the nongovernmental organization sector.

Juvenile Injustice: Police Abuse and Detention of Street Children in Kenya. New York: Human Rights Watch, 1997, 155 pp. $18.00 (paper).

Failing the Internally Displaced: The UNDP Displaced Persons Program in Kenya. New York: Human Rights Watch, 1997, 151 pp. $18.50 (paper).

These latest reports on Kenya examine abuses suffered by two highly vulnerable subpopulations. Street children, whose numbers have rapidly grown to more than 40,000 in the aftermath of the government's ethnic cleansing campaigns in the Rift Valley, face outdated laws and enforcement procedures that result in criminalization and mistreatment in an array of Dickensian correctional institutions. The other group, estimated to number about 300,000, are people who survived the cleansings but were forced off their land and have faced grim problems of survival and legal redress. The second report is a commendable effort to expose the serious shortcomings of the U.N. agency brought in to resettle these Rift Valley refugees. It describes how instead of fulfilling their responsibility to protect the rights of the internally displaced, the officials of the U.N. Development Program, bowing to intimidation by the Kenya government, deliberately ignored the human rights aspect of their mandate and treated the resettlement program as a mere relief project. Both reports contain detailed recommendations for institutions and agencies in a position to effect improvements in Kenya's human rights performance.

Unconventional Diplomacy in Southern Africa. BY ROBIN RENWICK. New York: St. Martin's Press, 1997, 163 pp. $45.00.

This unassuming memoir features the dramatic highlights of Robin Renwick's career as a British diplomat during the transitions to majority rule in Zimbabwe and South Africa. Two-thirds of the book is a blow-by-blow account of how Britain's Foreign Secretary Peter

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Carrington (to whom the author was a deputy) successfully bullied and cajoled Rhodesia's warring parties to accept a peace settlement at the Lancaster House conference in late 1979. Less "unconventional" but effective in its own way, was the author's own role as ambassador to South Africa from 1987 to 1991, related in the book's final portion. Despite dutifully carrying out Margaret Thatcher's policy of protecting British interests by fighting pressures for sanctions, the author earned the confidence of key players in the democratic movement as well as in the National Party, enabling him to act as an effective broker at important points during the country's political transformation.

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Letters to the Editor

Adam Yarmolinsky and Mark Schlefer on Weapons of Mass Destruction; Seth Cropsey on Serb Brutality; Donald Blinken on Why NATO Is a Bargain; and others

TWO WRONGS . . .

To the Editor:

Richard K. Betts recognizes the extraordinary difficulty of deterring a biological or chemical weapons threat, largely because "deterrence requires knowledge of who has launched the attack and the address at which they reside" ("The New Threat of Mass Destruction," January/February 1998). Yet he seems to feel the need for the United States to retain the option of nuclear retaliation for a chemical or biological weapons attack, partly because the biological and chemical weapons treaties deny it the opportunity to retaliate in kind, making nuclear weapons "the only WMD [weapons of mass destruction] available for retaliation." But if the source of a biological or chemical attack is a rogue nation, surely the overwhelming conventionally armed might of the United States will have as much deterrent effect as the threat of a nuclear response. For example, in the event that the U.N. Security Council decided to take out Saddam Hussein's suspected sites of biological or chemical weapons activity, the idea of employing nuclear weapons rather than conventionally armed cruise missiles would not be within the realm of rational consideration.

Suppose that the United States abandons its no-first-use policy, as Betts' logic seems to dictate. The consequences would be alarming. If the United States, the most powerful nation in the world, cannot secure even minimum protection against biological and chemical attack without threatening nuclear retaliation, surely no other nation, particularly those least able to defend themselves by conventional means, can afford to forsake a nuclear retaliatory potential. Iran, which experienced the impact of chemical weapons at Saddam's hands, comes immediately to mind.

Nor is it reassuring to argue that other nations could huddle under a U.S. nuclear shield. If Betts questions the likelihood that the United States would "follow through and use nuclear weapons" in retaliation against a WMD attack on its own people, what protection could another nation count on?

The threat or use of nuclear weapons would be an unlawful breach of binding commitments to the nonnuclear states. To induce them to agree to the unconditional indefinite extension of the nuclear nonproliferation treaty, the five acknowledged nuclear states in April 1995 undertook not to use or threaten to use nuclear weapons against any of them that are party to, and in compliance with, the NPT. Any American policy of deterrence that depends on a violation of these legally binding commitments runs

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a serious risk of starting a march by the nonaligned world out of the NPT itself.

ADAM YARMOLINSKY
Regents Professor of Public Policy, University of Maryland
MARK P. SCHLEFER
Washington, D.C.

THINK SMALL

To the Editor:

Betts overly concentrates on the short-term emergency management of biological weapons attacks. In the classical Cold War military model, the preferred biological warfare agents acted quickly, with the express strategic purpose of disrupting industry and large military formations. Terrorists, by definition, are more interested in manufacturing fear, and may exploit the latency of some diseases, or long periods during which no symptoms appear, where carriers are able to infect others. Smallpox has a latency period of 7 to 17 days. A single terrorist could, if infected with smallpox, strangle Egypt's tourist-based economy simply by walking around Cairo and calling a news conference after symptoms started to show. Few people would die, but the economic and regional political consequences would be enormous.

Betts' suggestions for how to deal with possible chemical or biological attack are all very broad. He argues for stretching limits of domestic surveillance, pulling back from excessive foreign involvements, and distributing protective masks. But instead of thinking big, the United States should emphasize training, disease surveillance, and contingency planning. Grand civil defense initiatives that fail will be a bigger blow to governmental credibility than doing nothing.

CRAIG HOOPER
Graduate Student, Harvard University School of Public Health

THE WAGES OF GUILT

To the Editor:

Charles G. Boyd demonstrates an inexplicably contorted moral sense that, by his own admission, ignores the Serbs' responsibility for the war in Bosnia ("Making Bosnia Work," January/February 1998). His confusion about the purpose of American policy in the Balkans is exceeded only by his sweeping bow to the fashion of "exit strategies," the limitations of which Gideon Rose sensibly points out ("The Exit Strategy Delusion," January/February 1998).

For good or ill, the United States recognized Bosnia-Herzegovina as a sovereign state in 1990. Serbian President Slobodan Milošević's military assistance to the Bosnian Serbs helped ignite the conflict the next year and contributed to the gross brutality that followed in its wake.

America's interest in a peaceful resolution to the Balkans' ethnic strife is grounded in the upholding of international standards like respect for borders and the prevention of taking land by force. It is not, as Boyd suggests, based on retribution against the Serbs. If that were the sole guide to American policy in Bosnia, the failure to arrest and prosecute such war criminals as Radovan Karadžić and Ratko Mladić proves the United States' painful deficiency.

But Serb brutality has not confined itself to Bosnia-Herzegovina. Milošević has just demonstrated in Kosovo his willingness to use Karadžić and Mladić's

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gruesome tactics. Secretary of State Madeleine Albright has said that Milošević respects only force and that the United States may need to use force to convince him and his zealous compatriots to respect the autonomy of the Albanian majority in Kosovo. Only if this lesson is clear to Milošević and the Serbs may peace come to a region whose ancient enmities threaten to undo the last century of America's efforts to bring stability to Europe. Until then, the United States must be prepared to stay the course. Boyd's confused and confusing musings do not help advance this decent, honorable end.

SETH CROPSEY

Distinguished Professor, George C. Marshall European Center for Security Studies

To the Editor:

Boyd incorrectly argues that by denying aid to Republika Srpska from 1995 to 1997 the United States has been perpetuating a policy of assigning blame for the war in Bosnia. For example, he wrongly asserts that only Serb towns have been denied aid due to noncompliance with the Dayton agreement. Muslim-controlled Bugojno has been blacklisted since 1996, and Croat-controlled Drvar was the subject of intense international pressure last year because of the local authorities' complicity in the destruction of abandoned Serb homes. And several Serb towns, recognizing political and economic realities, have embarked on refugee return programs and may be on their way to receiving aid. These towns include new Republika Srpska Prime Minister Milorad Dodik's home base of Lastasi.

The gradual economic revival in Bosnia has pressured the Serbs. Gradual increases in aid to both sides should be more tightly linked to full implementation, not unlinked.

Contrary to Boyd's opinion, refugee returns must remain nonnegotiable. Perhaps he is unaware of the intolerable economic conditions endured by Muslims and Croats displaced from Republika Srpska and scattered throughout the federation, or by Serbs from the Croatian Krajina and Sarajevo currently squatting in Serb territories. These displacements are a social pressure cooker that presents the greatest threat to the future of Bosnia.

Finally, Boyd's dismissal of the need to arrest war criminals ignores the progress made by the war crimes tribunal at The Hague in 1997. Almost all the Croat and Muslim indictees are now in custody. The Serbs feel The Hague is biased against them, but that is the product of their prejudiced media. The international community should not turn its back on war crimes suspects but rather step up its efforts to get the remaining indictees to The Hague—and away from the levers of power, where they invariably cause trouble.

LUKE ZAHNER

Deputy Spokesman, Organization for Security and Cooperation in Europe Mission to Bosnia and Herzegovina, 1995–97

FORWARD, SLOVENIA

To the Editor:

In their argument against NATO expansion, Ted Galen Carpenter and Amos Perlmutter describe Slovenia as a backward state with a backward army that could only be incorporated into NATO at great cost ("NATO's Expensive Trip East," January/February 1998).

But Slovenia is one of the five candidates for the approaching enlargement of the European Union. Slovenia has never

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received significant economic and financial aid from the United States or the EU. It has the highest per capita defense expenditure in Central Europe. But until June 1996, Slovenia was unjustifiably restrained in its efforts to modernize its armed forces by U.N. Security Council Resolution 713/91, which in September 1991 placed an arms embargo over the entire territory of the former Yugoslavia.

The Slovene parliament has decided that all new military equipment must comply with NATO standards. The Slovene army's modernization program follows closely the priorities set by NATO planners for all potential members of the alliance. Indeed, Slovenia's ongoing political, economic, and military development make it a clear front-runner for the second round of NATO enlargement in 1999.

DIMITRIJ RUPEL
Ambassador of the Republic of Slovenia, Washington, D.C.

ENLARGEMENT PAYS

To the Editor:

If Perlmutter and Carpenter's references to Hungary, one of the three new NATO members, are a measure of the soundness of their strategic thinking, one must seriously question their advice. For example, speculating on Russia's negative reaction to an enlarged NATO, they conclude that the Russians someday might be tempted to call NATO's bluff, and "the only way to minimize the likelihood of such a challenge would be to deploy robust NATO forces in the vulnerable front-line states." In fact, since late 1995 the alliance has deployed substantial forces in a front-line state, Hungary, with Russian cooperation. The authors are probably unaware that in recent months, the Russians have made strenuous efforts to sell the Hungarian air force additional MIG fighters—hardly the behavior of a country that views NATO enlargement as a threat.

The authors then suggest that Russia is not the only threat to Central European security. In particular, they note that Hungary could have security problems with three of its neighbors—Romania, Slovakia, and Serbia—over the treatment of Hungarian minorities in those countries. But it was precisely the opportunity for NATO membership that drove Hungary into signing basic treaties with Romania and Slovakia.

Perlmutter and Carpenter should stop worrying about the economic costs of the NATO enlargement and instead focus on understanding why enlarging NATO is in America's security interests. In the long run, extending NATO eastward will prove to be a bargain for Americans in ways that cannot be measured in dollars and cents.

DONALD BLINKEN
U.S. Ambassador to Hungary, 1994-97

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